

ROYAL COMMISSION ON THE TAXATION OF PROFITS AND
INCOME

MINUTES OF EVIDENCE

TAKEN BEFORE THE

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ROYAL COMMISSION ON
THE TAXATION OF
PROFITS AND INCOME



FIRST DAY

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Thursday, 21st June, 1951

WITNESS

LADY RHYS WILLIAMS, D.B.E.

Questions 1-208



LONDON: HIS MAJESTY'S STATIONERY OFFICE
1952

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TERMS OF REFERENCE

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages; to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer; to consider the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden fairly among the individual members of the community; and to make recommendations consistent with maintaining the same total yield of the existing duties in relation to the national income."

NOTE

For the guidance of intending witnesses the Commission published a list of the main heads under which evidence was invited. They explained that the list was not necessarily exhaustive and that witnesses could put in evidence on questions not specifically mentioned, provided that they fell within the Commission's terms of reference. The list is reproduced below.

A. General social and economic questions

1. Is the present system of taxation satisfactory, or could it be improved, in relation to:—
 - (a) incentives,
 - (b) risk bearing,
 - (c) encouraging savings,
 - (d) the control of inflationary or deflationary tendencies,
 - (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment,
 - (f) its effect on the distribution of personal incomes,
 - (g) other economic and social objectives?

These questions can be considered in relation to the taxation of:—

- (i) salaries and wages (P.A.Y.E.),
- (ii) profits of businesses and self-employments,
- (iii) dividends and other sources of income.

2. Would it be advantageous to link Income Tax with social security payments and contributions?
3. Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

B. Particular matters

4. Is the taxation net drawn too widely or too narrowly in relation to:—
 - (a) the taxation of United Kingdom residents (companies or individuals) on overseas profits,
 - (b) the taxation of non-residents on United Kingdom profits,
 - (c) the definition of residence, etc.?
5. (a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particular—
 - (b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?
6. Is the basis of computing income from property under Schedules A and B satisfactory?
7. Should the present rules about deductions for outgoings and expenses be altered?
8. Are the provisions for relief in respect of double taxation satisfactory?
9. Should the present system of graduation by means of the exemption limit, personal allowances, reduced rate relief and Surtax be altered?
10. Should the existing differentiation between earned and unearned income be extended or reduced?
11. Are alterations necessary in the rules governing personal and other allowances?
12. Should the rules about the taxation of husband and wife be altered (a) as regards aggregation; (b) in any other respect?
13. Should P.A.Y.E. be altered or abolished?
14. Should the principle of deduction at source be extended or restricted?
15. Should the method of assessment to Surtax be altered, and in particular should it be deducted from salaries?
16. Are any alterations desirable in the system of administration and the functions of the various statutory bodies or persons connected with taxation?
17. Are any changes in the provisions against avoidance and evasion desirable?
18. Is any alteration necessary in the rules governing the taxation treatment of special classes of taxpayers (e.g., public corporations, co-operative societies, charities)?

THE ROYAL COMMISSION ON THE TAXATION OF PROFITS AND INCOME

FIRST DAY

Thursday, 21st June, 1951

PRESENT:

The Rt. Hon. LORD JUSTICE COHEN (Chairman)

Mrs. VERA ANSTEE, D.Sc.
 Mr. W. S. CARRINGTON, F.C.A.
 Mr. W. F. CRICK
 Sir HARRY GILL, J.P.
 Mr. J. E. GREENWOOD
 Sir GEORGE HENYORTH
 Mr. J. R. HICKS, F.R.A.

Mr. N. KALDOR
 Mr. W. J. KIDWICK
 Miss L. S. SUTHERLAND, C.B.E.
 Mr. J. MELLARD TUCKER, K.C.
 Mr. G. WOODCOCK
 Mr. E. R. BRIDGES (Secretary)
 Mr. D. G. DAYMOND (Assistant Secretary)

LADY RHYS WILLIAMS, D.B.E. accompanied by Mr. P. A. GREEN; called and examined.

MEMORANDUM SUBMITTED BY LADY RHYS WILLIAMS, D.B.E.

INTRODUCTION

I beg to submit the following memorandum in support of my scheme for uniting income tax and surtax with the social insurance system. A version of this proposal has already been published by the Liberal Party Taxation Committee, and it will be supported in a further memorandum prepared by the Economic Research Council.

My memorandum falls into two parts:

I. *An outline of my present proposals, with two tables to illustrate their effects.* These proposals are adaptations of my original scheme, published in 1942, to meet present conditions, and they include amendments of the main idea which I support only as an interim measure.

II. *A discussion of the ideas and theories which underlie the proposals, and a summary of the advantages claimed for the scheme.*

PART I. OUTLINE OF PROPOSALS

1. The essential idea of the scheme which I submit is simple. It consists in a merger between the income tax and the social insurance systems, as a result of which all contributions would in future be made in the form of income tax, payable upon all the income of the individual whether earned or unearned. In compensation for the loss of the present allowances of untaxed income there would be granted weekly cash allowances, payable to every individual, on the lines of the present children's allowances. These would be in substitution for all (or part) of the present insurance benefits.

2. The original proposal, put forward in 1942, involved a weekly cash payment to every individual equal to the amount of the insurance benefits then payable, and the consequent cancellation of the entire insurance system. Although I adhere to this original proposal as being right in principle, I recognise that in present circumstances the complete scheme would require a rate of income tax to cover the cost of the scheme (in addition to the provision of the present yield of the tax for other purposes), which would be too high, and which might have a disincentive effect on production. I therefore accept as inevitable that there should be a preliminary stage, as proposed by the Liberal Party Committee in their pamphlet dealing with the scheme,* in which the positive payments which I proposed would be reduced to a smaller figure, and the system of insurance benefits would be continued on the present lines during unemployment, sickness, or in retirement, as a supplement to the proposed income tax cash

allowances. No supplement would be needed in the case of children, who would be adequately covered by the normal cash allowances.

3. I do not claim to be able to suggest what is the proper rate of income tax, or what the proposed cash allowances should actually be in present circumstances, since these figures depend upon the economic situation and the degree of inflation or deflation already in existence. In the attached tables (which are submitted simply for illustration) I have chosen the simple figure of 10s. per head per week for the proposed cash distribution, and calculate that this would have involved a 4s. rate of earned income tax on the basis of the 1950-51 Budget figures.

4. The selection of a 10s. cash distribution is in fact, the same choice as that of the Liberal Committee, since the figure of 12s. 6d. which they proposed was made to include a payment of 2s. 6d. per head per week to compensate for the cancellation of an equivalent amount of the food subsidies. Although I believe it is ultimately desirable to use cash benefits given under the scheme in preference to food subsidies, such a proposal is quite distinct from the scheme which I am putting forward, and I have therefore calculated the attached tables without reference to food subsidies, and have assumed that they were being continued at their present level.

5. In the tables attached I have retained the supplementary tax, commencing at £600 a year, which was proposed by the Liberal Committee, because I recognise the need in present circumstances, for a more progressive system of taxation than that implied by my original scheme, and also because I found myself unable to make a satisfactory estimate of the effects of any variation of their proposals. I am not, however, in agreement with the reasons for imposing the additional tax in addition to surtax which are given in paragraphs 67 and 68 of the Liberal pamphlet, where it is implied that there should be an upper ceiling to private incomes, nor with the general idea of imposing a supplementary tax distinct from the surtax system. I give my reasons for differing from the Liberal Committee's Report in paragraphs 6 and 7 below, and in Part II.

6. In my opinion the imposition of a supplementary tax upon incomes between £600 to £2,000, assessed and collected on separate principles from both income tax and surtax is an unnecessary complexity; I have included it in my tables merely because I could not illustrate the financial effect of a complete scheme of this kind upon the actual income of the average wage-earner and his family without making use of these figures, owing to my inability to recalculate them accurately in the form I

* *Reforms of Income Tax and Social Security Payments.* A Liberal Party Yellow Book published March, 1950.

actually propose. My actual suggestion is that a revised and remodelled surtax system should be brought into operation at £600 or £700 a year and carried up to the highest levels of income on a single evenly-graded scale administered by a single authority, instead of requiring two authorities and two sets of assessments and returns, as would the Liberal Committee's proposal.

7. The scheme I propose would thus consist of two and not three separate systems of income taxation, and would also abolish the poll-tax which is now levied under the name of an insurance contribution. (See Part II.) There would be:

(a) *The "Social Security" or "Welfare" tax*, levied upon all current earnings, on a weekly basis. This would represent in effect the citizen's method of paying for the social benefits received through the agency of the State by means of a single tax of so much in the £, in place of the present heavy flat-rate contributions, plus income tax. If the attached tables are substantially correct, the "Welfare" tax would amount to 4s. in the £, on earned income, and 5s. in the £ upon all unearned income which would be taxed at source.*

As explained above, the hardships which would arise from a 4s. tax levied universally upon all income would be entirely countered by the proposed system of positive cash allowances of 10s. per head per week, which would cancel the tax payments for the lower income groups and would mean that those in the very lowest income groups would actually benefit substantially by the scheme. The tables show that at no income level would anyone suffer any diminution of income as a result of the proposed changes.

(b) *The Income-Surtax*, levied in arrears, and after individual assessment, upon all income above a certain level.

(The figure of £600 a year was suggested by the Liberal Committee and is therefore repeated in the tables attached for the reasons explained. It is suggested, however, that a better level, in present circumstances, for the commencement of the surtax, would be £700 a year, in order to reduce the number of those assessed for this tax to the smaller proportions of the salaried workers, leaving the great majority of wage earners outside the surtax category. It may not, however, prove possible to avoid going down to the £600 level, for financial reasons.)

8. It is suggested that those features of the present income tax which have proved to be just and satisfactory should be incorporated in the Income-Surtax system, including the principle of making allowances of non-taxed income in respect of children and dependants. The Report of the Royal Commission on Population contains ample justification for the grant of relief from tax for those with children to support at a scale which rises in proportion to income, and I consider that at the higher income levels, in which individual assessment of income is in any case necessary, it is probably more convenient to carry out this principle by way of negative allowances than by positive cash payments, which can give rise to the absurd duplication of being themselves subject to tax.

9. The Income-Surtax system proposed should not enforce the joint assessment of income of husband and wife, a principle which is totally unjust under present social conditions.

The Insurance System in relation to the Scheme.

10. The modified scheme outlined above does not, unfortunately, entirely effect the major administrative simplification proposed in the original scheme inasmuch as it does not abolish the need for supplementary benefits to be paid during unemployment, sickness and on retirement; but it does effect some simplification, by abolishing the stamping of cards and the differential basis of contributions. All payments by the worker would, under the scheme, be made through the income tax system, and not by flat-rate contributions, which tend to be very unjust in their incidence, and which no longer reflect any genuine insurance element in view of the very large supplementation which is required, from funds contributed by the general taxpayer by other means. This supplementation

will assume constantly greater proportions as the rising age of the population demands greater expenditure upon pensions, and it is difficult to see upon what logical grounds it is claimed to be necessary or desirable to levy a part of the sum needed for welfare expenditure on a flat-rate basis when taxation according to income is generally accepted as a much fairer system of contribution than a poll tax.

11. It is a matter for consideration whether the existing machinery for administration of insurance benefits would have to be retained in full, or whether some simplified system would be sufficient once the scheme was in operation. The scheme would reduce the administrative work involved for several reasons:—

(a) individual contributions would no longer require to be collected and accounted for on a personal basis;

(b) in future every individual would be eligible for benefit, no further regard to the amount of his contributions being necessary when considering his right to benefit;

(c) children would be exempt from the scheme, since the cash allowances already paid in respect of each child (including the first) would be larger than the insurance benefits payable at present;

(d) owing to the regular receipt by each individual of 10s. per week (a benefit which would not preclude him from undertaking work on a part-time basis, since it would be payable universally), it is possible that application for the supplementary insurance benefit would not always be made in the case of short periods of illness or unemployment. Owing to the amount of certification involved, and the fact that part-time work has to be discontinued both by those making a claim and by their wives, the supplement (amounting to only about 3s. per day for a married couple at present rates of benefit) might not seem worth applying for in many cases. This factor, if it became important, would, of course, still further reduce the cost of insurance benefits.

12. Owing to the rising cost of living, the statutory insurance benefits are unlikely to be sufficient in future to maintain, above the level of want, those families suffering from total lack of earning power owing to unemployment or sickness. Supplementary aid by the National Assistance Board will therefore be necessary in the majority of cases unless the statutory benefit is raised. It is possible that, if this scheme were adopted, the administration of unemployment and sickness insurance benefit and retirement pensions could eventually be merged with that of the National Assistance Board. The rise in the cost of living means that applicants for benefit, being entitled only to the amount of the statutory insurance payment without means test, will require to submit to examination of their circumstances before receiving adequate maintenance. If the National Assistance Board and the Insurance Authorities were merged, the further enquiries entailed would at least be conducted by the same authority; only one set of officials would be involved, and only one set of forms required in the case of each applicant, instead of two or more as at present. I have not, however, had the opportunity to give serious study to this proposal, and I do not press it. I much prefer an adequate rate of benefit granted without means test, if the economy of the country makes this possible.

13. It will be noted that the attached tables do not exempt the employer from his payment of insurance contribution on the present scale. I do not concur with the proposal to abolish this contribution which is contained in the Liberal Committee's Report. (Para. 69.) There are many other forms of taxation of industry which are more urgently in need of repeal than this particular contribution.

Detailed application of the Scheme

14. I am anxious not to put forward proposals concerning the detailed working of the scheme in any but the most tentative sense. It is the main principle and not any of the detailed suggestions which I am anxious to place before the Royal Commission for its consideration. The following proposals are therefore only included by way of illustrating and clarifying the main proposal, and in no sense as if they were essential features of the scheme.

* See Part II.

* See Part II for a discussion of the theoretical basis of this scheme.

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[Continued]

15. (a) *Payment of the 10s. cash allowance*

I consider that this is a personal payment, and should be made direct to each adult individual and not to some other person on his or her behalf. For this reason I consider that a wife is entitled to receive her allowance direct and not through her husband; but this proposal is not a part of the scheme itself. Children's allowances would be payable to either parent, or to a legal guardian on behalf of the child, as in the case of the present children's allowances, which would of course be merged into the new scheme.

In the case of wives and dependants, and pensioners, I assume that the payments would be made in the same way as separation allowances were paid during the war, i.e. by the issue of books of dated coupons cashable at any Bank or Post Office. If the pressure upon the post offices were too great, as a result, it might be found desirable to license suitable shops to act as sub-post offices for the purpose of cashing the vouchers.

Alternatively arrangements could no doubt be made for the books to be deposited with the employer and for the sums due to be included in the wages packet, either for the wage-earner himself only, or for himself and his wife and children. The vouchers would in either case be forwarded to the Inland Revenue by the employer or by the post office (or shop) as evidence of encashment, and they would entitle the employer (or post office or shop) to receive the equivalent sum in repayment.

The distribution of the books of vouchers could be "staggered" over a considerable period in order to reduce the pressure of work falling upon a certain date, as in the case of ration books.

(b) *Deduction of tax*

This would be carried out by the employer as at present. Being a simple deduction of a fixed percentage (20 per cent., i.e. 4s. in the £) from every pound earned, and from every employee alike, the work of administering the tax collection would be very greatly simplified as against the present system of P.A.Y.E.

Part-time workers such as charwomen might find it easiest to keep a book to which each employer might affix postage stamps to the value of one-fifth of the earnings shown, deducting this amount from the sum paid.

In the case of those self-employed persons, from whom it is difficult to obtain returns of income earned, it is suggested that they might be assumed to be earning a net average of, say, £10 per week, and on this assumption be asked to remit to the Exchequer a sum equal to 20 per cent. of this amount weekly (i.e. £2 per week) unless they produced evidence that they were actually earning less than this figure. In this way fairly accurate returns might be expected from them in cases where genuinely small incomes were being earned. Those earning more than £100 a year would be on the borderline of assessment for Income-Surtax as described above, and could perhaps be dealt with by the Income-Surtax assessment machinery.

Encouragement of saving through the scheme

16. It is suggested that the introduction of the scheme might give a greatly increased impetus to private saving, particularly in the lower ranges of income, if arrangements were made to credit sums saved from the cash allowances to the individual's account at the Post Office Savings Bank. A form could be signed by the individual anxious to save, authorising the deduction of one or two shillings a week from his 10s. benefit (or even perhaps, surrendering the whole cash payment) the amount agreed upon being automatically credited instead to his account at the Post Office Savings Bank. In the case of children, parents might be willing to authorise the banking of all or part of the weekly allowance in the name of the child, thus providing a small fund, available later on for expenses incurred by special training, an entering business, or for marriage.

The possibility of saving automatically, by the mere signing of a simple form, and of obtaining immediate investment, with interest, without further trouble, should make saving much more attractive than under existing conditions. It would be a case of easy "contracting in" to save, and of being faced with effort if desiring to "contract out", instead of having to make continuous mental and physical efforts to save and invest small sums weekly, with the risk of robbery necessarily involved if

the savings are made in cash and remain uninvested for long.

The Financial basis of the scheme

17. The attached tables (which were prepared before the rearmament programme was in view) are based upon the same assumptions as the calculations in the Liberal Report. They show the seemingly impossible result of raising slightly or substantially the weekly income of every individual in the country without diminishing the yield of income tax for the general purposes of the Exchequer. Although more or less the same results as these have been reached at different times in the last nine years by a number of different experts making independent calculations about the effects of the scheme, it is natural that the figures should, on each occasion, be queried on the grounds that they show an impossibly favourable conclusion.

I therefore set out what I believe to be the explanation of the apparent discrepancy.

18. There are two factors inherent in the proposal which affect the figures, although it is not possible to set them out plainly in the tables. These factors are:

(a) The cessation of the present overpayment of insurance contributions which, having been calculated on the basis of an expected average of 81 per cent. of unemployment, which has not been fulfilled, have built up a large capital fund. This surplus amounts to £157 million in the period referred to in the tables attached. This excessive insurance contribution, being no longer collected under my scheme, the surplus naturally reverts to the present contributors in the form of a larger weekly income retained after deduction of all taxes and contributions.*

(b) There is a substantial reduction in the amount which would be paid out annually by way of insurance benefits under the scheme, since the first 10s. of the statutory benefit for each individual is already provided by the Social Tax allowances which are granted as a replacement of the present personal allowances of untaxed income and other rebates. This economy has not yet been accurately calculated, but may be of the order of £80 or £90 million under present conditions. It would be much more if unemployment were to rise by even 1 per cent. This saving is reflected in the tables, inasmuch as the total cost of the scheme, which includes the cost of insurance benefits, is thereby reduced. It does not, however, appear as a reduction of the weekly expendable income of a given family in employment, and it is (inevitably) this latter income which is shown for comparison in Table II. As a result of these two factors, I believe that the tables contain a concealed advantage of from £200 to £250 million in favour of the scheme. This may account for the improvements in incomes which the scheme produces, and which are not illusory.

19. It may be argued that the proposed cessation of the present build-up of the Insurance Fund requires to be taken into account in the preparation of an overall type of Budget such as the present one, and that the scheme would therefore show a deficit if considered against the background of the total national balance sheet. I believe that, against this deficit, it would be correct to set the saving on insurance benefit payments referred to above, a saving which would be larger (just as the cancelled surplus would be smaller) in a year of less completely full employment than 1950-51, but this saving would only become visible the following year. It is possible that the two factors would actually cancel each other out in a few years, even if only on account of the rising age of the population and the consequent increase in pension payments.

However this may be, I suggest that there is a fundamental dishonesty about the exaction of a consistently excessive rate of insurance contributions from the wage-earning classes, and the use of the resulting surpluses to build up a fund which is not in fact required for the genuine purposes of the insurance system in present conditions. This large fund, concerning the management of which no adequate account is normally given to Parliament in the Budget speeches and reports, is becoming a

* The existing capital of the Insurance Fund is not in any way affected by the scheme. It is merely the large annual increase of this Fund which is discontinued.

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major factor in extra-Budgetary Government finance, and is capable of causing trouble by its very size. It seems as if it should on no account be increased. I consider that if large amounts of excess taxation are required, for whatever reason, the surpluses so raised should be plainly shown in the Budget statement, for the ordinary taxpayer to see and understand, and should not be disguised as insurance contributions, for which it is assumed, no explanation is needed in a Budget discussion of other forms of taxation.

The two points raised above might be summarised as follows:—

The scheme appropriates the existing annual surplus on the Insurance Fund, although it leaves the existing

capital untouched. At the same time it reduces the annual cost of each benefit by 10s. per head per week, because it makes use of the same 10s. weekly benefit offered by the scheme (in exchange for the present allowances of untaxed income) to cover the first 10s. per head per week of the insurance benefits.

These results are not, of course, deliberate; they are the automatic effects of the major simplification which the scheme makes possible. They could, if necessary, be cancelled by adjustments in the rate of tax, of weekly cash benefits or of unemployment and sickness pay.

Arguments in support of the principle of the scheme and of its advantages are contained in Part II.

Table I

TABLE ILLUSTRATING LADY RHYNS WILLIAMS' INCOME TAX REFORM PROPOSALS

STATEMENT OF REVENUE AND EXPENDITURE ON ESTIMATED BASIS (1950-51)

(The figures in this Table are estimates only, based on 1950-51 Budget figures. The basis of their calculation is that of the Liberal Report, revised to omit Food Subsidies and to retain the Employers' Contribution. They are supplied for illustration only, and are not claimed to be accurate.)

REVENUE		EXPENDITURE	
<i>Income Tax</i>	<i>£m.</i>	<i>Social Security Payments</i>	<i>£m.</i>
At 4s. in the £ on £8,407m. of earned income . .	1,681	Personal Allowances at 10s. per week	1,014
At 3s. in the £ on £1,307m. of unearned income	327	Children's Allowances at 10s. per week	286
At 5s. in the £ on £1,111m. (a) of undistributed profits	278	<i>Supplementary Allowances (see Liberal Report, Schedule I, page 34, item (b))</i>	397
	2,286	<i>National Health Service</i>	358
			2,055
<i>Supplementary Tax (on basis of Liberal Report, Schedule I, p. 34)</i>	400	<i>Contribution to general Government expenditure (b)</i>	887
<i>Employers' Contribution to National Insurance</i>	194	<i>Surplus Balance</i>	58
<i>Surplus</i>	120		3,000
	3,000		3,000

Notes:

(a) £1,305m. less £194m. Employers' Contributions.

(b) Gross Yield of Income Tax per 1950-51

	<i>£m.</i>
Budget	1,388
Gross Yield of Surplus	120
	1,508

Less: Direct Savings on basis of Liberal Report, excluding food subsidies

621

887

Table II

EXAMPLES OF WORKING OF SCHEME ON BASIS OF 4s. INCOME TAX AND 10s. WEEKLY DISTRIBUTION SHOWING COMPARISON OF NET INCOMES (1950-51 FIGURES)

	Gross Income			Taxation			Net Income	Present Net Income (Round figures)	Net Saving	Per Cent. of Present Net Income
	Annual Earned Income	Personal Allowance at 10s. per week	Total	Basic 4s.	Supplementary	Total				
Single Man or Woman.	£ 200	£ 26	£ 226	£ 40	—	£ 40	£ 186	£ 182	£ 4	2.2
	400	26	426	80	—	80	346	343	3	0.9
	600	26	626	120	—	120	506	480	26	5.4
Married Man, One Child.	200	78	278	40	—	40	238	187	51	27.3
	400	78	478	80	—	80	398	375	23	6.1
	600	78	678	120	—	120	558	535	23	4.3
	800	78	878	160	13	173	705	667	38	5.7
	1,000	78	1,078	200	33	233	845	795	50	6.3
	2,000	78	2,078	400	133	533	1,545	1,435	110	7.7

(For relative effect of scheme on other categories, see Liberal Party Yellow Book, Schedule II)

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[Continued]

PART II. THEORIES UNDERLYING THE PROPOSALS, AND SOME ARGUMENTS IN SUPPORT OF THE SCHEME

The Scheme considered as a Contract between the Citizen and the Community

21. The basic principle of the scheme, as originally put forward in 1942, was summarised in the name then given to it—"A new social contract." Since then, the proposal has been discussed chiefly in the light of its practical applications and details, its main object having been recently described as increased incentive to overtime work. I would like to stress that this aspect of the proposal represents only a small part of the objectives of the scheme. In this memorandum I attempt to outline some of the wider implications of the proposal, as originally conceived, because these earlier ideas seem to be particularly applicable in present circumstances.

22. The idea was, and is, that all those welfare services which are provided by the State to every individual should be included in a single comprehensive system, to be paid for by the breadwinners in each family, not by way of flat-rate premiums, but by way of a percentage of income, to be called a "welfare contribution" and not considered as a tax in the ordinary sense. The rate of this contribution would be calculated each year in strict accordance with the proposed outlay on the social services.*

23. At the back of this proposal lies the assumption that the relationship between the citizen and the State falls into two parts, which ought to be kept distinct from one another from the financial point of view. In the first category come the dues which have always been claimed from the citizens of civilised communities by the rulers or Governments, and which might be called the "national taxation" payments, namely the costs of Justice, order, defence, the Crown, Government administration, the National Debt, public works, and so on. In the second category come the social services, which are, in effect, merely a convenient arrangement whereby the citizen makes use of the central (or local) Government machinery to provide himself and his family with goods, services, or benefits required to fulfil his personal needs, and which, without such arrangement, he would have to provide out of his private purse. The fact that the development of statistical science and of administrative machinery has proceeded so far today that it is possible to prepare a comprehensive scheme of this kind, upon genuinely actuarial lines, and to pay for all the varied benefits by a single contribution based upon a percentage of all income, does not alter the fact that the essential element in such a scheme is that of purchase by the individual citizen of the benefits and services which he desires to have, using the State as his agent to carry out his wishes.

24. Such a scheme should be thought of as a giant insurance system, in many ways similar to the present one. The difference is that the contributions would be made in accordance with income, and the whole range of modern welfare services would be included, instead of those only which happened to have been approved at the time when the idea of a national insurance system was first adopted in this country, more than forty years ago.

25. In such a picture, the conception of universal cash allowances, which is an essential part of my proposal, falls into place as one of the many forms of social benefit which the citizen would be choosing to purchase with his welfare contribution. These allowances would replace the existing negative allowances of the income-tax system, which have come to be regarded in the light of actual benefits, and which are, in disguise, an important part of the present welfare plan, being the State's acknowledgment of the needs of families in the middle levels of income.

26. With taxation at its present high rate, remissions of tax granted to certain classes or groups, if they involve an increase of the taxation of other groups, are identical in their effect with the grant of positive cash allowances, or free services. It is not correct to speak of them as if they were true remissions of taxation unless the whole

range of taxes is being similarly reduced. I stress this point, because the substantial remissions of income tax to those in certain income brackets which have been made in recent budgets have been accompanied by increases in purchase taxes, tobacco duties, etc., and have therefore represented, not genuine remissions of tax, but rather the grant of the equivalent of cash benefits to single people, earning good wages, at the expense of families at all income levels who have to buy taxed goods. If it had been fully understood that these remissions are, in effect, cash benefits for certain individuals at the cost of other taxpayers, their anti-social nature would have made them unacceptable. It is for this reason, in particular, that I consider that the open grant of cash allowances is more desirable as a means of dealing with the problem of family maintenance than the present complex negative allowances, especially as it also assists those below income-tax level.

Advantages of the Scheme

(a) Practical Advantages

27. The benefits of the scheme fall into two groups, the practical and the psychological. I have included in the latter many points which would in fact have an immediate practical effect (for example, the encouragement of saving) leaving for the former only the most obvious advantages, such as:

(1) Economy in Clerical Manpower

28. This would be effected not only in the Inland Revenue, but throughout industry, by the ending of the individual collection of insurance contributions, with all the card-stamping work and entries which this involves, and the replacement of PAYE codes by a universal deduction of a fixed percentage of all income, from all employees alike. The economies here would be very large. There could also be economies at the Ministry of National Insurance for the reasons outlined in Part I, paragraph 11. The National Assistance Board would have a substantially smaller burden due to the reduction in the number of applications following the grant of the universal benefit of 10s. a week. Against these savings must be set the increased work involved by the periodical distribution of books of weekly coupons to all adults; but this would not burden every employer in the country as do the present PAYE scheme and the stamping of cards for individual insurance.

(2) Increased Incentive

29. By ensuring that the rate of taxation on earnings did not rise above 4s. in the pound until after £12 per week was reached, the discouraging effect of high taxation would be removed for the majority of wage-earners. In addition, the rate of tax on married men with children or other dependants to support, earning £500 a year and over, would be appreciably reduced by the scheme, which would thus help to restore incentive to increase earnings among salaried workers.

(3) Improved Opportunities for Self-Help by the Unemployed

30. Instead of remaining wholly unemployed and dependent upon insurance benefit (or, as seems probable owing to rising prices, insurance-plus-assistance), those who elected not to receive the supplementary payments from the Insurance Fund, in addition to their normal cash allowances, would be free to undertake part-time work to augment their income. There would be no question of unfair competition with others, since all would be receiving the same allowances as themselves. A man with a wife and two children, having a regular income from the scheme of 40s. a week, could in most cases bring the figure up to much more than the statutory amount of unemployment benefit by undertaking odd jobs, and his wife could do the same. The possibility of providing local schemes of self-help for the unemployed in areas hit by severe structural or temporary unemployment would be greatly increased by the scheme, since half the burden of maintenance would be provided without loss of the right to earn supplementary amounts. Inasmuch as such efforts were successful, the cost of maintaining the unemployed would be taken off the Insurance Fund.

(4) Inclusion of the existing subsidies in the Social Services

31. Although as stated in Part I, the abolition of the food subsidies is not part of the scheme (being a matter for political decision), if the scheme were introduced the

* If the above theory were to be accepted in full, the figures in Part I, Table I, would require rearrangement and modification. As far as the food subsidies should clearly be included in the welfare group, to be financed out of the 4s. contribution. The revenue from the supplementary tax and certain would still go to the National Endowment. The revenue of the scheme would then be £2,480 million and the expenditure £2,455 million, an approximate balance.

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way would be cleared for this to be done if thought desirable, as is pointed out in the Liberal Report. The scheme makes possible either a selective or a general increase in weekly cash payments to be granted in compensation for the withdrawal of the food subsidies. Without the scheme, additional machinery would need to be created to provide the compensation which would be essential if grave hardship was to be avoided. Other subsidies besides those on food could, if necessary, be dealt with in the same way. In particular, the scheme might provide a solution to the problem which Lord Beveridge, in his report, confessed to finding insoluble, namely the provision of compensation for those unemployed who live in areas with an unusually high average rent, and whose insurance benefits are therefore insufficient to maintain them without Means-tested assistance. This represents a real hardship to thrifty workers, who find themselves at a disadvantage in comparison with others in low-rented districts. It is possible that the problem could be dealt with under the scheme by the grant of higher rates of allowance for those living in such areas.

(b) Psychological Advantages

(1) Avoidance of the Necessity for the Means Test

32. As pointed out in paragraph 30 (above) the value of statutory pensions and other benefits has been so much reduced as a result of devaluation and narmament that it has become necessary, in many cases, to supplement them by means-tested assistance. If this trend is continued, and particularly if pockets of unemployment develop as a result of shortages, or of the redeployment of industry, this necessity will become the rule rather than the exception. The first shock of unemployment may be cushioned by the reserves of several good years of full employment and saving, but as these are used up, the need to apply for National Assistance among those thrown out of work will become widespread. I consider this to be a most undesirable development, both from the point of view of the Exchequer and of social justice. I differ strongly from those who look upon it as a safeguard of the taxpayer's purse. Such a notion is based upon failure to appreciate the change in the outlook of the lower-income groups which has taken place in recent years.

33. At a time when centuries of social condemnation of the indigent, and harsh treatment of applicants for relief had produced a feeling of shame when help was required, the indignities of the Means Test represented a genuine barrier against misplaced applications for relief; but matters are quite otherwise to-day. The comparatively generous scale of national assistance, which has risen with the cost of living, and the privacy under which it is granted have removed the old dislike for its receipt. Assistance grants are thought of in the same light as all other benefits provided by the State, whether statutory or otherwise. The normal, self-respecting citizen can see no reason why he should deprive himself of pleasures and comforts while his earnings are good, in order to save for old age or bad times, since by doing so he will gain nothing, but on the contrary will lose the substantial Assistance benefits which he could otherwise receive. It is not at all surprising that the will to save has already been largely destroyed, since it is bad business for any wage-earner to undertake provision for his own future, and so lose his pension from the State. The Means Test thus provides a strong discouragement to thrift and independence of spirit, and it also creates a sense of injustice, for the bias against the hard-working members of society is keenly felt by them. Grave harm is being done to the national character by the growing dependence upon means-tested assistance, as will be discovered when it is too late for a remedy.

34. My scheme does not, of course, entirely avoid the need for means-tested assistance for the destitute, but it greatly reduces it, by providing a certain amount of benefit (10s. a week) even for those not entitled to retirement pensions, without submission to a means test, and so encouraging the individual to try to find for himself, even when old, or in poor health, or unemployed. (See paragraph 30, above.)

(2) Encouragement of Saving

35. The provision of greatly simplified methods of saving and investment for every member of the community (see Part I, paragraph 16), would also assist in restoring the sense of independence and thrift.

(3) Reassurance of the Taxpayer

36. I believe that this aspect of the scheme is, in present circumstances, of prime importance, and I therefore deal with it a little more fully than the others.

Mr. Aneurin Bevan has said that the revolutionary force which is visibly at work in the world to-day is not Communism but Egalitarianism, and I believe this to be true. The egalitarian impulse has, in Russia, been captured by the traditions of oriental tyranny, and has become merged in Russian Imperialism, but in the West it is still working hand in hand with Parliamentary democracy.

37. In this country, in the last ten years, the normal machinery of taxation has been used as an instrument for the redistribution of wealth, and this has been possible because the conscience of those who paid the high rates of tax has been, on the whole, in alignment with the policy of redistribution. The abolition of want has been accepted since the time of the Atlantic Charter, and before, as an object for which confiscatory taxation must be endorsed.

38. Although the principle is almost universally accepted that want and avoidable sickness should be ended in this country, the precise limits of this policy are a matter of controversy, and the recent dispute over the imposition of charges for teeth and spectacles is a symptom of this disagreement. Where the benefits for which they are paying are provided to all comers, and not merely to relieve destitution, taxpayers feel increasingly that the redistribution of income may be carried too far.

39. The problem of where to draw the line has been greatly complicated by the rapid disappearance of the geographical boundaries hitherto accepted as the chief safeguard to the taxpayer against undue burdens. It is not yet twenty years since the support of the destitute was first accepted as a national duty even in Great Britain, having until then been at the charge of the Local Authorities since the time of Queen Elizabeth. The principle of "fair shares" is working like a leaven throughout all the poor and backward parts of the world, as logic and ethics alike demand that it should: if it is right in Britain it cannot be wrong elsewhere. From the West Indies, Malta and other places, deputations have argued with Socialist Ministers that it is morally wrong for the British to enjoy luxurious social services and a high standard of living while serious poverty continues as the result of policies maintained by the British Government.

40. The Marshall Plan and the Colombo Plan are proof that both American and British taxpayers consider that it is their duty to provide, on a large scale, economic help for countries other than their own. In short, the idea is spreading apace that rich countries are responsible for the welfare of the backward areas of the world, and must tax themselves for their benefit.

41. This is a revolutionary conception indeed; but in spite of the growth of this sense of international responsibility and the realisation that the prosperity of the richer countries is rather attenuated than harmed by giving economic aid to poorer areas, there must be a limit to the demands made *ex of right* in both national and international affairs.

42. If this matter is left for decision by sheer weight of numbers, or by pressure groups, the effect on the very capacity of wealth to give continued assistance to poverty would be disastrous. The fact that there must obviously be a limit to redistribution of wealth in the international field argues that there must be a limit also in the sphere of national and local taxation. The safeguard of the taxpayer must consist in the acceptance of a clear principle, which will guide the decisions of successive Chancellors, to whatever Party they belong.

43. What, then, is the principle which can decide the just extent of the claims upon the taxpayer? I suggest that it is the principle of insurance, which has been accepted by the public since the beginning of the century, and is fully understood. But, obviously, to continue to link the concept of State insurance to the payment of flat-rate contributions is a mistake, just as it is obvious that steeply progressive taxation should be levied in order to provide the finance for universal social benefits of a lavish kind. Much evidence in favour of the grading of contributions in relation to income was submitted to Lord Beveridge when he was compiling his report, but this method was, unfortunately, not adopted by him,

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44. I consider that the principle of grading contributions in strict proportion to income is just and acceptable. It is fair that every pound earned should yield the same amount for the welfare of the community. What is anachronistic is that a flat-rate charge (in effect a poll-tax) should be bolstered up by unlimited support claimed from the hard-working members of the nation as a matter of right. It is on these grounds that I disagree with the Liberal Committee when they propose to include in the financial basis of the scheme a supplementary tax which would increase the rate payable above £600 a year on a progressive scale. Such a tax should not be included in the finance of the social services. Progressive taxes of this kind, admittedly necessary because of the heavy burdens of defence and the service of the national debt, should only be levied for such urgent national needs. In grave emergencies, all measures are justified, but the continuation of confiscatory taxation, devised for the prosecution of war should not be incorporated in the permanent structure of the Welfare State. Taxation for the benefit of others must be paid by consent, and not as an act of constraint: as a gift, and not a robbery.

45. If taxation is considered unjust, the effort to avoid tax by legitimate means, which already occupies an undue proportion of the time of business men, will become an effort to evade taxation by any means, leading, perhaps quickly, to a situation in which there is a total disregard for the law, as in America during Prohibition.

(c) *Simplification of the whole System of Taxation*

46. It is partly to arrest the development of tax evasion as an ingrained and publicly approved habit, as on the

Continent, that I press the need for simplification of the taxation system. It should be comprehensible without the need for expert interpretation. Under the present complex and constantly changing system, even the honest taxpayer, desirous of paying the right figure, can easily become involved in illegality, a fact which provides a wide avenue of escape for the dishonest one. The major simplification of income-tax law which my scheme would bring about would, in itself, help to arrest this process. In matters of taxation, as in law, it is not enough for justice to be done; it must manifestly appear to be done. But under such an over-extended system as the present, this is no longer possible. It is only by a major simplification that the ordinary taxpayer can regain his faith in the justice of the principles under which he is taxed. His confidence to-day is upheld only by his high regard for the integrity of the Inspectors of Taxes, on whom he knows he can rely.

47. The only effective safeguard, both against abuse of the public services and evasion of taxation is a clear understanding by everybody of the principles underlying the whole structure. It must be well understood by all that inefficiency and waste in administration and abuse of the facilities are in fact hurting all contributors alike, since the benefits depend for their very continuance upon the economical management of the whole scheme.

I believe that a powerful impetus would be given to the growth of an active and co-operative public opinion by the announcement of a radical reform on the lines which I propose.

EXAMINATION OF WITNESS

Lady Rhys Williams subsequently submitted to the Commission further written evidence containing modifications of her scheme and incorporating revised figures. Her oral evidence should be read with this in mind.

Chairman: You have been kind enough to get in a memorandum for our assistance in connection with the task that lies before us and some of us have also read your earlier book. Before we ask you questions about your memorandum, is there any statement you desire to make in extension of your memorandum?—I have had a good many comments from different people to whom I have sent the evidence since amending it; perhaps I can make comments on one or two additional points but it is as you wish, would it be better if you asked me questions?

2. We may not cover the same points as are covered in your memorandum. Add anything you desire to.—First of all I want to stress that the present scheme is not the same as my original scheme. I abandoned my original scheme for the reasons the Liberal Party* abandoned it and the *Inland Revenue*† commentator abandons it. I realise the disincentive of the high rate of tax would be undesirable, but I disagree with the view that the scheme altogether abandons the idea of social security and welfare services. I feel it has a good many other points which are quite distinct from that one point which was one feature of the first scheme. I do not know that I need outline that scheme.

3. You can take it we have read every document you have sent in to the Secretary.—I wanted to stress the point that I am not abolishing the contribution by the employer which makes quite a substantial difference to the figure as distinct from the Liberal scheme. The Liberals abolished the contribution by the employers and my scheme does not do so.

4. We shall have some questions to ask you about that.—I only explain that because it makes a good deal of difference to the figure. I wanted to concentrate my argument to-day on an aspect which I only touched on in the second part of my evidence, which was the desirability of linking the whole of the welfare outlay of the Government in one giant insurance scheme, as I call it. I am claiming that my scheme would extend the insurance principle, although on a contributory basis, that is

to say on an income tax basis, to the whole of the social security and welfare services. That is what I am effectively doing and financing the whole lot with a 4% tax. I wanted to stress that aspect of it, which I think I did not bring out quite clearly in the written evidence. The other point I wanted to make a little more strongly than I did was that a great feature of the scheme is that it is more just than the present system, once just and simpler and has social advantages. It is not merely aimed at administrative simplification. One of the reasons why I think it is more just is because I think the insurance system as at present worked is extremely unjust. I think, to begin with, that people pay in at a time when money is worth more than the benefits when they get them out. I think that the harshness of a true insurance scheme is applied as if it were a true insurance system. For example, expectant mothers have to work so many weeks in order to get their benefit even when their health is not up to it, otherwise they forfeit their benefit, and various points of that kind. The fact that it is not a true insurance system is shown by the fact that if it were they would not have built up the enormous fund which has been built up. They would have lowered the contributions or increased the benefits. I think there is a real injustice in making the same standard benefits to-day, when they are not adequate and have in many cases to be supplemented by means tested assistance, yet in keeping the enormous fund built up. I feel that alone shows the insurance system is not genuine. There are other aspects of the system which I do not want to go into at great length, but equally the taxpayer is very much unprotected by an insurance system which is supposed to cover the main benefits, which works on a poll tax basis with all its hardships and then has to be supplemented by an enormous amount of completely unprotected taxpayers' money. There is no insurance principle there at all. I think it is wrong to limit the insurance system to the type of benefits that were available in 1911 which is approximately what is done, or similar benefits, that is to say pensions.

5. If you are talking of the kind of benefit I can follow that point, but surely the quantum of benefit has altered very materially since 1911?—I will try and make my point more clear. The point is that the Health Service, the food subsidies and a whole lot of other benefits have been added, quite rightly in my opinion, to the welfare system, and the principle of insurance was limited to certain benefits while the taxpayer carries all the others. It was limited to the benefits available in a scheme a long time ago. I claim it should be extended to the

* A Liberal Party Yellow Book entitled *Reform of Income Tax and Social Security Payments* referred to on page 39 of these minutes (Second Day).

† Memorandum on the subject by the Board of Inland Revenue is reproduced on pages 59-66 of these minutes (Third Day).

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whole of the present welfare benefits. I distinguish those from other reasons for which taxation is levied by the fact that the beneficiary obtains something back for the amount he pays in. To-day he is getting a great many benefits straight off the taxpayer and I feel all those things make the insurance system as at present run an anachronism and undoubtedly redundant. I claim it ought to be remodelled, quite apart from any administrative simplicity, in the interests of justice. Then I feel that there is a grave danger in utilising the insurance system for anti-inflationary or for anti-deflationary methods. I know this is allowed under the Act of 1946. I know the reasons why that was put in, I sympathised at the time, but I think that the result of them is entirely to confuse the public mind. They do not understand anti-inflationary taxation and they get a sense of injustice as the result. They do not know what it is about and I feel that growing sense of injustice is very serious. It is leading to a desire to evade taxation and I have seen it grow in my lifetime from the honest man thinking it would be terribly wrong not to pay his tax, to almost everybody being willing not to pay it.

6. Is not that due to the height of the tax rather than to any particular system?—No, the height of the tax is another point, but I am saying it is due to the method of the tax. People do not understand their tax, they have to get experts to explain it to them. The P.A.Y.E. scheme is very complex. It means their pay packet is different at different times of the year. The whole thing is rather incomprehensible to the ordinary person and I feel that incomprehensibility leads to a desire to evade the tax; public feeling is no longer with the tax.

7. Your scheme would not in any way deal with the avoidance of surtax?—I am not talking of surtax at all. I am talking of the lower levels.

8. The complications of the Acts are surely mainly due to provisions which are directed to preventing avoidance of surtax?—I am sure there are a lot of complications there but it is not what I was referring to. I was referring to the fact that most people do not tell when they do work on a Saturday. There is a general feeling it is perfectly all right to diddle the income tax people. They feel it is absolutely fair. It has got a little bit like the situation in Prohibition times in America when everybody giggled about the law and helped to evade it. I think that is the situation to-day. Everybody tries to prevent their income being known. A lot of people do. There is a change in public feeling due to the extreme complexity of the whole thing. They are not with it. It is partly due to the mix-up of inflationary and disinflationary theory in taxation with the real business of paying for the benefits they receive. I am sorry if I have not made it very clear. Perhaps I have not done it very well.

9. No, I follow it.—Professor Meade, who supports my theory and has written to support it, points out to me that the scheme as I put it up makes it very much easier to use the taxation system for inflation and disinflation purposes. I agree, I think my scheme is lovely for that purpose, but I do not think it is necessarily right to do so. I feel very strongly the use of the insurance fund for that purpose has been unjust and wrong. I also think it is inflationary inasmuch as we have put a heavy poll tax on the lowest income grade and helped to force up wages for that reason.

10. I follow that.—I would like to run through the social advantages of the scheme which I have not touched on in any of my papers, I think they have point. First of all there is the fact that the scheme tends to transfer income from the hands of the wage earner to the eater in the family. It gives 10s. a week to the eater, I say "eater" advisedly. It might be the man, it has nothing to do with the feminist point of view. I feel in inflationary periods there is a lag between the wage earner passing on an increasing percentage of his wage to his wife. The social services show that. He does not appreciate how prices have risen and he tends to give her the same amount as he gave before.

11. I do not follow for the moment how your scheme will disburse him of that idea?—Under my scheme his wife would get 10s. also 10s. for each of their children. There would be a packet going towards the wife.

12. So the children's allowances under your scheme . . .

—I am not trying to change the law about children's allowances, but the children's allowances go to the wife, therefore there tends to be an increase in the family income. If you look at the trend of taxation during the last ten years the taxpayer is perpetually having to come to the rescue of the catering section of the family by food subsidies and all sorts of other means, price controls and so on, and perpetually having to take it back off the amusements, the beer, tobacco and so on of the wage-earning section. I am not trying to make an attack on the wage-earning section, I am merely showing you that this scheme carries that principle a little further and is desirable socially. I am very interested in nutrition, I always have been, and there is a risk of mal-nutrition arising all over again owing to rising prices; the effect of that is not appreciated and the wage earner does not sufficiently increase his wife's share of the income. That is one of the social points. The second point is I think that it does increase the status of the wife, there is a real point there, for her to receive her own income. It is not a necessary part of the scheme. It could be paid through the husband if that was thought necessary, but I am fighting for it to be paid direct to the wife. I think she needs it. Very often she has been earning before she was married and she needs to have some portion of the household income herself in her own right and it would have a good effect on the status of married women which is desirable. The third point which I did touch on in my report but not very deeply was the position of the unemployed. I think there is a real point particularly in cases of pocket unemployment, that the enterprising unemployed would rather be pleased to try and earn on a part-time basis if the opportunity were given them and not to take the whole of their unemployment benefit. That would perhaps not be possible if they were getting nothing at all but if they were getting 10s. it would increase their sense of independence, they would try to do without the dole and fend for themselves. It also makes it possible for local authorities to provide schemes of employment for the unemployed and it would be extremely advantageous. I have a lot of experience of this point as when I first thought of the scheme it was largely to meet this problem which arose so very heavily in the inter-war years. The last point is that I do think it would make for a healthier relationship with the young people. It would be possible to make the grant of the first book of coupons into a sort of ceremony when leaving school and becoming entitled to full citizenship. It could become quite an important occasion where they might learn to realise the benefits of the present social system that have been built up through the efforts of the community and for which they have a duty to the community in return. I think it would help to stir the imagination of the youth if there could be this sort of school leaving ceremony when this would be brought to the notice of the young people. It is a small point but I think the school teacher would say it was important.

13. It is getting rather far from our terms of reference.—It is important for social aspects to be kept in mind. I also feel very strongly the present system does need amendment and this scheme should not be considered entirely in the terms of the criticisms of the Inland Revenue which I shall be glad to deal with.

14. I am bound to put some questions to you on this. You will remember our terms of reference conclude with the observation that we are to make recommendations consistent with maintaining the same total yield of the existing duties in relation to the income as I am afraid we cannot ignore the effect on the Revenue.—Yes, I did not speak to it because I thought you would wish to question me on it. Those are all the supplementary points.

15. First of all may I ask you this question? The Liberal Party in their Yellow Book made some criticisms of your original scheme. I gather with a few exceptions you accept their criticisms as necessary to be adopted at the present time?—Yes.

16. The principal difference between you still is that you retain the employer's contribution?—And I do not abolish the food subsidies.

17. I do not think I shall trouble you, speaking for myself, about the food subsidies point, because at any rate financially it makes no difference, that is covered by your

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reducing the benefit to 10s. instead of 12s. 6d. Now one of the attractive features at first reading of your original proposals was the practically complete fusion of social security in income tax. That has to some extent gone, has it not?—Not entirely.

18. First of all you retain the employer's contribution; secondly you still have to provide unemployment, widows and sickness benefit—I recognise they have to be supplemented, so you have to retain certain machinery for doing so, but there is a great deal of simplification all the same. You have not got to do the card stamping or distinguish between one contributor and another.

19. How are you going to collect the employer's contribution; it looks to me as though you put one stamp on instead of two?—I had imagined the employer would be taking the 20 per cent. off the wages and forward it together with his own flat rate contribution for the employee.

20. What is the justification for abolishing both the employer's contribution and the State contribution to the insurance fund while retaining the employer's contribution?—Because I think the employer's contribution was always part of the scheme and I am not trying to vary the principle of insurance at all. It was to relieve the employee of a certain amount of contributions he had been making before and it was all part of the picture. I am not attempting to give away tax in that way.

21. I thought the principle of the scheme before, was that it was a contributory scheme as in the case of private firms contributing to schemes, the employer should contribute and the employee in order to make it possible to make rather more generous benefits than would have been possible only by a State grant. If you knock out the employer's contribution will not the employer think this is a special tax on a particular taxpayer not borne by others?—That would be true, but I am not knocking the employer's contribution out. I am increasing it in some degree. I am merging it with his income tax and he must pay 4s. in the £. You cannot say he is not paying anything.

22. Turning to the benefits side you agree there would still have to be unemployment benefit, sickness benefit and widow's benefit?—I should like to comment on the unemployment benefit. Under the rising prices we are suffering at the present time the existing benefit will have to be supplemented by means-tested public assistance in a large proportion of cases before very long so we have got away from the idea that we are looking after the unemployed by this benefit and that alone already. As prices rise in the next few months it will become apparent to everyone that these contributions are insufficient so we are going over to the National Assistance method of dealing with it.

23. That will still be necessary under your scheme?—I have not calculated it but I believe it would be possible to simplify, to make the National Assistance organisation the one that deals with all those persons who wish to take the unemployment pay.

24. This is a point some of us were not clear about. It will still involve the retention of the means test. Whether you administer the thing by the National Assistance Board or as it is at present entirely, in any event a means test would, under your scheme, be applied to those who came for supplementary assistance?—I should like to make it clear my scheme gives 10s. without any question. Above that they are entitled to 26s., then is 16s. supplement. They would get that in addition if they chose to apply for it. If they got that they would not be able to work, they would have all the disabilities we know that attach to that. I believe a great number would elect not to take that additional amount and would try to work but having the benefit of 10s. That is only an opinion, it might be wrong, they might apply for the extra and they would get 26s., that is to say 16s. extra without any means test. National Assistance would come to the rescue under the existing scheme, nothing to do with mine, in addition.

25. That is what I meant.—That is the position now. My point was that I believe that situation will develop so rapidly that the administration of unemployment assistance as an intermediary thing will soon become almost redundant.

26. If they become unemployed they will not take anything more than their 10s.?—If they were able to get any work at all they would not. If they are not able to

get work they would not in any case be able to rest upon the 26s., they would not be able to live on that without supplementing their income, therefore, they would in any event have to be handed on to the National Assistance people in a very short time. At that stage the National Assistance organisation would be dealing with the case and I suggest they would be able to deal with it by giving so much without a means test and so much with a means test if that was the law, but it does not need an intermediary organisation I believe.

27. I was only saying that if they wanted anything from public funds beyond the 26s. there would still be a means test?—Yes. I am inclined to think the administrative simplification is still there, it is not abolished by the change in the scheme.

28. You have seen the memorandum of the Board of Inland Revenue?—Yes, but only for one day.

29. I was going to put a certain number of questions to you on it. If you feel yourself unable to deal with them because you have not had long enough do not hesitate to say so. In order to facilitate matters, if you find there is any point that has not been dealt with it will always be open to you to put in a supplementary memorandum dealing with the points. It may avoid asking you to come back on a future occasion. First of all will you turn to paragraph 22 of the memorandum? You see it states what the Board understood to be the objectives of yourself and other similar schemes as being first to amalgamate income tax and social security in a single coherent and logical system. Secondly to remove the disincentive effect of the present income tax by substituting a flat rate tax, and thirdly to simplify administration. Would you agree that the objectives of the scheme have been accurately summarised there?—I have added others today in my first answers to you. To my mind it is a very large social question and nothing like as small as it looks here. That is only a very small part of the whole problem.

30. You would agree those objects were some of the objects you had in mind?—Anyone who read my book would know the objects were very much wider than these objects but these are some of them.

31. I think that, having regard to the modifications which necessity has imposed upon us as set out by the Liberal Party Yellow Book, you would not suggest that the first object there stated is achieved by your present proposals?—I disagree. I think one could make a logical system of it even if there is a proportion of it which has to be allowed in the form of supplementary benefits in between the income tax allowance and national assistance. But I think it is possible to make it much more logical than the present scheme.

32. You think it is more logical but you agree that if you retain unemployment and sickness benefit you have not achieved the objects you had in mind?—Not the whole of them, I agree.

33. Will you turn to paragraph 23 where the Board say: "If the scheme is satisfactory as social insurance the rate of tax required is so high as to be a disincentive; if the rate of tax is kept down on incentive grounds the benefits which can be given are too small to be effective as social security." What I was going to ask you was how you got out of the dilemma there pointed out?—I think that is a very true dilemma and I should like to accept it. I worried for ten years over that dilemma, nevertheless I maintain it is not a fair thing to take that as being the only advantage of the scheme as originally based. I hope to clarify it in this way, but I consider even the 10s. allowance is a very great contributory factor to simplification especially in the P.A.Y.E. aspect of it.

34. Whether there is justification for saying that even on the 10s. basis the dilemma exists depends very much on whether the Board's finance figures are right?—I agree.

35. By assuming the Board's finance figures are right it would mean even to carry out your 10s. scheme we should have to increase the 4s. to such an amount as to lose some of the incentive benefits?—I think not, but that is what I should like to have an opportunity of discussing. In the very busy examination I was able to give the figures yesterday I think the difference between my scheme and the Liberal scheme and a number of the other points...

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36. I am coming to the figures later. I am only suggesting to you if the Board's figures are right and they were to carry through your scheme it must necessarily mean a considerable rise in the 4s. and 5s. rates?—Even if the Board's figures were entirely accurate, which I do not think they are, I think it would not be more than 4s. 6d. even then.

37. Perhaps I should tell you at once the Board say that on your 1950-51 figures they estimate the error amount in all to some £540 million?—That is because they are putting in £214 million of which I utterly disapprove.

38. But you agree 6d. would not produce another £540 million?—No, it would not produce that.

39. My recollection is that the Chancellor said one shilling produced something over £100 million?—But that is income tax with all the allowances off it.

40. I am told on your scheme one shilling would very nearly produce the £500 million?—I know it is a lot, that is why I do not think it is as much as one shilling. It would be about sixpence even if the whole of the cost was taken which I shall dispute.

41. The next point I am going to put to you is in connection with what you said earlier. I have a little difficulty in following you. I understood you to say that under your scheme the pensioners' scheme remains a contributory scheme?—Only in the sense that if you are paying 4s. in the 2 you are contributing to the whole security services.

42. Therefore under your scheme you are not bringing all the benefits under the insurance umbrella but you are bringing all welfare benefits under the Exchequer umbrella?—But divorcing it from the ordinary purposes of the Chancellor and bringing it under one scheme.

43. With one tax which is applicable for meeting all general expenses of government?—As I hope and believe the 4s. tax, or 4s. 6d. if it must be, but I hope it will not, would cover the whole of the social benefits and if any extra were added it would automatically affect that tax or reduce the contributions. It would be in that sense an insurance system. I have not made clear that the balance of the contribution to the Exchequer is covered by the supplementary tax, the tax on incomes above £600.

44. That produces on your figures some £400 million. That would not go very far towards paying for the general budget of the country?—It is not the only tax. We have Customs and Excise duties. Mr. Green will deal with these figures better than I should. I think it would be better if he explained these points.

45. I think my last point was a bad one.—The supplementary tax as amended would have to be raised to 3s. in order to meet the criticisms of the Board, but in that event it would cover the whole yield for the purpose of the Exchequer less the amounts that would be taken off the cost to the Exchequer and put against the social welfare scheme.

46. Would you turn to paragraph 35 of the Board of Inland Revenue's note. They there point out that at the present moment when you are considering the question of the incentive you have to bear in mind out of 19 million people with earned incomes below £650 and above the exemption limit of £135, 6 million pay nothing at all?—But they do pay insurance.

47. They pay insurance, that is true. Four million pay 2s., they leave out insurance in these figures, 8½ million pay only at 4s. and three-quarters of a million pay at 7s. 2d. They therefore say that of the 19 million with earned incomes below £650 a year, 18½ million would pay a higher rate under the umbrella scheme than they do at present?—They would get 10s. rebate.

48. Do you not think the workman would think he was worse off if the amount in his pay packet is less notwithstanding he may be going round the corner to the post office to collect something?—The fact is his income would be slightly increased by the scheme and I think it would be quickly made clear to him.

49. You mean not his by himself but his and his wife's?—Even his. May I say that according to my calculations even his own income is approximately the same or identical. I should like to produce my revised figures for what they are worth.

50. I was looking at your table II. £200 a year, you reckon he would be £4 better off?—On a revision of my figures I calculate that the single man is £5 better off, but that the married man with one child is £46 better off if his income is all "earned" and £36 if it is "unearned". This is because I believe I can maintain the 4s. tax. I admit it would not be quite so favourable if it were 4s. 6d.

51. How do you propose the 10s. a week should be paid, would he go to the post office to collect it or would it be added to his pay packet?—The majority of the workers would hand it to their employers and it would be in their pay packets but I do not think that need be compulsory.

52. It would add to the burden of work thrown on the employer?—I am very sure I do not add to the burden of work thrown on the employer. I cancel all the work he does to-day under P.A.Y.E. and insurance stamping. I think the employer might have to include it as a kindness or I think a number of shops could be licensed just to cash the coupons in addition to post offices if it were considered too much for the post offices. It is a very simple operation.

53. Now I want to go to the figures, and if at any stage you would rather let Mr. Green answer do not hesitate to let him do so. For this purpose I will take table I included in your evidence?—Which were my own poor efforts. They were not properly checked, and I am not guaranteeing them at all.

54. Can you tell us first of all where you got your figures of income? You put down earned income at £8,407 million, unearned income at £1,907 million and the undistributed profits at £1,111 million. We have been unable to trace the origin of those figures?—They were taken from the Board of Trade report. I simply took the old Liberal figures and brought them up to date. I did not do anything with them.

55. The Liberal figures were 1948; you are purporting here to give 1950-1951?—They were an effort to do that, perhaps an amateur effort.

56. According to the Board of Inland Revenue the proper figure for earned income is only £8,150 million?—Is that taking into account the item I should like to dispose, the item of £214 million referred to in paragraph 2 (b) of Appendix I to the Board's memorandum?

57. That is a different point. I am coming to that later. It will arise I think when I am dealing with the yield which appears at the bottom of your figures. Then I am told the right figure for unearned income is £1,267 million which is slightly more than your figure?—That is the 5s.

58. That is the first 5s. The figure for undistributed profit is £1,025 million. If you make the corrections which are mere mathematics to arrive at the yield it would mean for the figures in the last column you would have £1,630 million instead of £1,681 million, £542 million instead of £337 million, and £256 million instead of £278 million, giving a total of £2,228 million. The supplementary tax, and here you cannot be blamed because you have taken the Liberal figure, but basing it on the figures in the White Paper, I am told the right figure is £311 million?—I accept it of course.

59. I am giving you these figures so that you may know what they are. The employers' contribution to National Insurance I am told you have slightly under estimated; it should be £198 million. The surtax produces £125 million. That will bring the total to £2,862 million instead of £3,000 million. Now we go to the social security payments and I am told here the only difference between us is that you have slightly under estimated the population, that the right figure is 50.7 million and the total therefore for those two figures should be £1,318 million. I have some questions to ask you about the figures but for the moment I am giving the right figures. Supplementary allowances based on the Liberal report, I am told the cost would be £469 million not £397 million?—That is giving something different from what I say. Had I under estimated what had to be given?

60. It is No. (vii)—I have accepted that point.

61. National Health Services, again they agree your figure so the expenditure would come to £2,145 million. New Government expenditure, I am told the right figure there is £598 million. I will explain to you how we arrive at that in a moment. The reason is that according

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to the Board of Inland Revenue you have under estimated gross yield of income tax for a reason that is explained in this report and the right figure there should be £1,619 million including the £125 million for surtax. In your note (b) the figures should be £1,494 million instead of £1,388 million and £125 million instead of £120 million making a total of £1,619 million. The Board of Inland Revenue agree it is right to deduct £621 million leaving a total of 1998 million. So if you add 1998 million to £1,145 million the total expenditure involved in your scheme is £3,143 million and that means instead of a surplus of £54 million, there is a deficit of £281 million. I said I would explain to you some of those figures. So far as the revenue is concerned on which you base your 4s., those are taken from the White Paper—I am sure they are right.

62. The explanation of most of the other figures is to be found in these notes. The reason why the £1,388 million has to be increased to £1,494 million, this is where your quarrel about the £214 million comes, the Revenue say, and prima facie it seems to me to be right, is because if you take your proposed rate of tax on the income arising in the year 1950-1951 you must compare with that the yield from the same income although it will not in fact be paid until the subsequent year—I have heard this argued for quite a long time and I am not prepared to agree it. The experts who have advised me think that argument wrong. I am not clever enough myself to say anything on that point but I understand the Liberal Party are going to deal with their points tomorrow and I would rather you put it to them because they are more qualified to reply than I am. It seems to me you have only to regard it in a common sense way. Appendix 2 of the Inland Revenue's comments on the Liberal scheme makes out that the scheme is going to make everybody in the country except a few people considerably worse off.

63. But when you are making calculations you must make both on the same basis?—Surely.

64. Have you anything to say on the second criticism that you have included in the income upon which you base your calculations certain income which is not taxable, viz. such matters as payments in kind and tax free allowances?—I should like to accept that view but though I cannot make the calculation there are considerable points in favour of my scheme. There are the people in prisons, those in hospitals who would have 10s. towards their keep. I think that should be taken into account.

65. No doubt if you are going to give us a memorandum later on these points can be included?—I should like to try and do so, in the one day's notice I have had I have not had sufficient time.

66. Have you anything to say now about undistributed profits?—Mr. Green: There is one point. Undistributed profits the point which is made there is first that profits tax should be deducted not at 10 per cent, but at some higher rate, because the profits tax applicable to distributed profits must be deducted from the undistributed income. It is difficult for the mere layman to ascertain what the profits tax at the higher rate is because of things like abatement and investment income which operate to reduce the tax. You cannot say it is 50 per cent, or 40 per cent, on distributed profits. The Inland Revenue did not make the point nor did they concede the point that profits below £2,000 will not be liable to profits tax even at 10 per cent, and profits between £2,000 and £12,000 will only be liable at an abated amount.

67. I am told they have not taken those into account in arriving at the £155 million.—No, I cannot see how they arrive at their figure.

68. I am told that the Board of Inland Revenue have taken into account the amount actually chargeable which does take into account those figures.—It was not evident from this, otherwise the point is conceded that profits tax at the higher rate should be deducted.

69. Anything else?—In the case of Lady Rhys Williams' scheme the second point (b) in paragraph 2 (iii) of Appendix I to the Board's memorandum is not applicable because as she has already said the contributions will be paid.

70. The employer's contribution will be taken, therefore I think they have taken that into account in arriving at the adjusted figures I gave you.—Yes.

71. Now the next point, the figure is larger in your case. They say you over estimated the supplementary tax at 38 million. That was bound to be with you a matter of guesswork?—Yes, Lady Rhys Williams: It was impossible to get the data to compile correct figures.

72. I quite agree. Turning to paragraph 2 (v) of Appendix I to the Board's memorandum there is the suggestion there that you failed to include cash payments to replace life insurance. I am not sure whether you are suggesting in your scheme getting rid of life insurance relief or not?—I am afraid I have not properly considered it in this memorandum but I think what is necessary should be given though I do not go all the way with the Liberal Party. I did not know the magnitude of this.

73. When I said that the supplementary allowance figures should go from £197 million to £469 million, that increase was based on the assumption that you were proposing to get rid of life insurance deductions. No, I am wrong. I am told if you get rid of Schedule E expenses, double tax relief and life insurance relief, those three would cost another 295 million. What I do not know from your scheme is whether you propose to get rid of those three or not?—In the original scheme I meant to give that relief. I must admit I did not give proper consideration to it before putting it in. Now I do not know whether my figures do allow for it and after seeing the great magnitude of the thing I should like to think about it.

74. The figure of £281 million that I gave you did not include anything for that. It would mean another 290 million.—May I have further time to consider that point?

75. What do you say about the under estimate of the number of persons unemployed, sick and widowed, do you want to say anything about that now, sub-paragraph (vi)?—There was a point on the widows, my scheme gives the pension automatically at 60 in any event and we have allowed for that so it is only between 50 and 60 that this arises. It is a smaller number than you have allowed for. We thought there was an abatement there.

76. If I may leave this for one moment, it is clear, is it not, that in certain respects your scheme gives additional benefits over the benefits at present received under any scheme?—In comparatively few cases; with the old people it certainly does.

77. I wondered if you had formed any estimate of how much your expenditure is due to increased benefit?—I have tried to do that, but I cannot do it, I have not the data.

78. Will you deal now with sub-paragraph (viii), National Insurance Fund surplus, and the item of £24 million which appears to have been brought in twice over?—We agree that is an error.

79. I think that takes me through all the items on which your figures are challenged except the £171 million which it is suggested ought not to have been included for the surplus. In paragraph 19 of your scheme you refer to the existing annual surplus on the Insurance scheme but you will not raise that in future.—No, I have admitted that.

80. You seem to have taken credit for it by implication.—I do raise it because we have allowed for it, people are paying the 4s.

81. Have you not taken it in twice over?—Mr. Green points out to me I have not taken the credit for it.

82. The £542 million which was the figure I first gave you is made up of £281 million with the correction you made, the £90 million for the double tax relief and so on and the £171 million which the Board of Inland Revenue say you ought not to have taken the credit for. That makes a deficit of £542 million.—I am still allowed to dispute the £214 million. May I speak apart from that issue?

83. You can dispute it and you are going to put in a note explaining the reasons?—The Liberal Party are going to, but I will supplement it if I do not think it is good enough.

84. You will no doubt be listening to them to-morrow?—So I understand.

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85. Personally I have very few questions I think I need trouble you with now.—May I explain that I reject the view which appears to be put in this that the whole of the changes in tax must come upon the lowest incomes. According to my scheme, if it had been right, I was really helping the richer people more than I expected to do. It came out like that. It quite worried me. The benefits at the higher levels of income were larger than I expected and I would like to suggest I am not trying to provide a great philanthropy to a lot of people. I was trying to arrange the tax in a better and simpler way. It is not necessary to keep to a flat-rate tax and make it 5s. It could be 4s. and let the balance be carried by a supplementary tax.

86. You suggested the supplementary tax should be merged in the surtax.—Yes.

87. That would mean a great many more people would have to file returns of total income for surtax purposes.—Not more people but fewer people would have to file returns of income because there would be no need to assess them under £600. The first assessment would be at £600, a great simplification. Above £600 they would have to be assessed and carefully investigated and I am not able to say what the rate of tax should be. I merely make the point that it is not necessary to put the whole of it as an extra shilling on the lower levels of income. I am not prepared to say exactly how it should come but I did a hasty calculation of a shilling extra on the supplementary tax to see how it would come out and it showed that it was unnecessary to change the 4s. tax. I do not know whether the figures are right in the light of the discussion to-day but I dispute the view that the burdens would all have to come on the poorest people if there were these changes.

88. I do not think the Board of Inland Revenue were suggesting where the money was to 'come from.—The reason I make the point is that the Inland Revenue table is out to make fun of the Liberal report.

89. Not make fun.—Forgive me, to put it in its worst light. It makes the extra cost all come with heavy minuses on the poorest people. I suggest that is a real misunderstanding of the scheme.

90. No doubt the Liberal Party will emphasise that view. You have answered all the questions I want to put but I expect many of my colleagues have questions for you.

91. Mr. Millard Tucker: May I ask one or two small points, only very small points. I am a little concerned about the proposal to pay everybody 10s. a week. It is a colossal weekly pay roll.—I am always anxious to give mothers and children more than they are getting. I do not think they are getting enough. I have given all my life to getting them more to eat but I would agree it should perhaps be only 8s. for the children.

92. I do not mean the amount but the numbers of people involved in it. Everybody gets it, 50 million people.—Yes, but it is not really an enormous administrative point. Five million people got it during the war when there were separation allowances without any very great administrative difficulty. Ration books are handed to everybody. The coupons could be staggered. They do not have to be all given on the same day.

93. Five million is rather different from fifty million.—The ration books are given to fifty million. Perhaps the Food Offices would be the proper people to deal with it, I do not know.

94. I want to get this quite clear. I gather everybody in the country is to get 10s. a week.—That is the theory.

95. Whether they earn any income or whether they do not?—Yes.

96. In some way or other that has to be paid?—Yes.

97. So far as employed people are concerned you suggest that that could be done easily by the employers?—Yes.

98. But what about the wife of the employed person, will she let her husband get hold of the 10s.?—If she has any sense she will not.

99. She will want to draw hers separately?—Quite right.

100. What about the 10s. for the children?—That would be exactly like the 5s. to-day, either parent. I am not trying to alter the law.

101. Prima facie it would be the mother you would want to get it?—I hope so.

102. There are 52 payments to be made in the year and I think you suggest a sort of book of coupons should be issued?—Yes.

103. Would not there be a grave risk that quite a number of people will sell those books of coupons to somebody?—I do not think so. There are a great many ways in which that could be got round. I have a great respect for the Board of Inland Revenue. Anybody who could invent the P.A.Y.E. scheme and carry it through could do anything.

104. Perhaps they could reduce the tax for us if they can do anything?—I wish they could.

105. To come back to these books of coupons. First of all I suppose that means a lot more paper?—I do not think so. I think it could be done very much on the principle of the ration books. We have been through all this in the war. It is very well understood.

106. I am sure it would be well understood if once it came into operation.—Nothing could be more difficult than what they are doing now. The amount of time taken up by clerks now in calculating it is fantastic. It is true they are not paid by the Board of Inland Revenue but by the employers but it goes on to the prices in the country.

107. You would be surprised if you knew the comparatively small extra staff that is required even in a big concern for P.A.Y.E.—I saw the figures for the railways and I was staggered at the size of them.

108. I am speaking of a big commercial firm.—A big commercial firm tells me the cost of P.A.Y.E. alone in clerks' wages was £15,000 a year.

109. I am not thinking of the labour staff of employers but of the staffs who will have to pay out weekly.—Not weekly, forgive me, I imagined it six monthly.

110. I thought it was to be paid out weekly, 10s. a week?—It was a book of coupons. I am not saying whether three months or six months. That is an administrative matter, but they could get a book of weekly coupons which could be cashed on the date or after the date. They would be valueless before that date and they would be cashable at a Post Office or at approved shops acting as the Post Office or by the employer.

111. When you are dealing with the weekly wage earners who are having 4s. in the £ deducted from their wages, they will want their 10s. that week?—They will get it from the employer.

112. Chairman: I think you are at cross purposes. When Lady Rhye Williams talks of six months, she is talking of the issue of the book.

113. Mr. Millard Tucker: I am talking of the actual cashment.—I imagine the employee would hand the book to his employer and get the money each week. I think the wife will be pleased with her book, she can put it away safely and she will cash it at the Post Office or at the local grocer when it suits her to do so after the date named on it.

114. That is a tremendous amount of extra administrative work for somebody each week to cash 30 million payments.—I forget how many letters are carried by the Post Office in a day.

115. I do not know about letters.—I am only suggesting it is a very much larger figure than this.

116. Would there not be considerable queues on a Friday at the Post Offices?—Why should there be. They might get it some other day.

117. You do not feel any practical difficulty about it?—I do not. I think it can be done in shops. Post Offices are not the only places, there are the Co-op stores and the big shops who would be only too glad to do it. They would be only too glad to attract the extra support.

118. Perhaps the new betting shops?—Even the new betting shops might be suitable. I feel the administrative difficulty has already been dealt with during the war on this point and is thoroughly understood by the admirable experts in the Civil Service.

119. Only this one other question. I put it before but I did not get an answer that I think covered it. How are you going to prevent a woman who has her own book of

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coupons and her children's book of coupons from selling that book for a lump sum to somebody else?—It would of course be illegal and there are other means of stopping it. Exactly the same point arises with children's allowances to-day and it does not seem to be a problem. How is it dealt with? Perhaps the Inland Revenue can inform us.

120. I do not know how children's allowances are dealt with?—In exactly the same way as I am suggesting.

121. By a book of coupons?—Yes.

122. Do you have to produce your identity card when you cash them?—I am afraid I do not know. My children are all too old for me to draw allowances for them.

123. *Mr. Sutherland*: I wanted to ask one question generally, that is, whether there is not some danger, if the whole population had even this small sum per week, that you may not have cases in which that acted as a disincentive to work. I was thinking particularly of young girls because I think there might be a danger that young girls living at home, if they got 10s. a week for nothing, would be tempted either not to take a job which they otherwise would do to get ready money, or they would work rather spasmodically or take a half-time job instead of a full-time job and that is not what we want?—I see the point very much but I suggest the mothers who will have been getting the 10s. before will be asking for it still if the girl remains at home.

124. I wonder. It is not very easy to say how that sort of thing would work out.—I hardly see why the mother should suddenly give up the 10s. she has been having to feed the child.

125. I suppose when the child drew it herself her own attitude might change too. I should have thought socially speaking the general tendency would be as when girls get their first pay cheque they keep it, so their first insurance cheque, particularly if it was attended with some ceremony as you suggest, it would make them think they were now part of the receiving body?—I hope the educational authorities would be able to instil in these girls a sense of social responsibility. They receive this money from the community and they must give their best in return. I think it might be an aim of education. 10s. is not very much.

126. *Mr. Ansell*: I would just like to ask you to explain a little more fully your attitude towards proportional as contrasted with progressive taxation. Why do you prefer the proportional system of taxation under £600; your flat rate, which is a proportional rate?—Two reasons: one for administrative simplicity, because I think the importance of simplicity cannot be over-estimated. People must understand their tax better than they are able to do to-day if they are to co-operate. They simply cannot cope with the complex changes involved in the present system. They either employ other people to do it or just give it up. Therefore to be able to take off 20 per cent. and add 10s. to the remainder is of great value. The second point is that at present we have a flat rate poll-tax which has its defenders; but I am deeply opposed to it and think it is most unjust. It has its defenders on an insurance basis: to jump from poll-tax right up to progressive tax, to 19s. 6d. in the pound on the highest income as your supplement in the social insurance system seems to be wrong. My suggestion is to take a point proportionate to income, neither poll-tax nor progressive, for this particular middle range, partly for simplicity and partly half way between poll-tax and progressive.

127. I wonder what you think about retaining the progressive principle above £600. Do you wish to retain that permanently, not only as a temporary measure?—I think it is frightfully important that the general taxpayer of the country should feel that he is not going to be permanently and for ever penalised. He should be able to feel that the present situation is due to war, the results of war and the imminence of another war; that he is still under emergency difficulties, but that he has the hope, with the return of real peace, that his tax might come down a bit. You must give him some hope that that progressive taxation would be reduced, and it would be much more possible to reduce it if it is in a separate category than if it is mixed up with the whole system. The social security system should pay for itself, the whole measure

should pay for all that it provides, and that is important. If the national income went up as a result of increased production, that 4s. tax would come down. With increased production and a bigger national income it could go down. The supplementary taxation should be higher in an emergency and there should be some hope of a reduction when the emergency is over, otherwise you will break the heart of the taxpayer.

128. I understand. Do you think that the progressive principle is really fairer?—I am not perfectly sure that it is. I put in my report why I am frightened of it. It is because the Channel is no boundary to ideas. This idea of progressive taxation could spread all over the world. I have just been in a big conference of Commonwealth representatives who speak very strongly about the high social level of benefits in Britain, and the low levels in Jamaica and other islands under our control; the effect of the cheap sugar in Britain on the natives of the West Indies for example. There was an interesting letter in "The Times" a couple of days ago by Mr. Bing where he showed how, if the progressive principle is accepted, it is going to have to spread over the whole world. I think it is a very serious principle to adopt. It would mean the high level incomes of America and Britain would be scattered down to the lowest Asiatic state; there would be no resting place. I feel frightened that the result of that would be to lower the capacity of the rich to help the poor at all. It would not really make for the riches of the world.

129. I understand. I was only wondering why, if you did...—I think there is a danger in accepting it. We are thinking about not only England but the world to-day.

130. *Mr. Bick*: I wonder if I might ask you some rather more general questions about incentives. You began by telling us that one of the ideas you started with was thinking about these people who were receiving unemployment benefit, but who were capable of doing a certain amount of work, and you claimed that the existing system would have a damaging effect in that direction. I think I would agree with that, but is it not the case that one of the great difficulties about your plan is that if you take the very large number of people who at present fall below the level of effective income tax payers, so that they fall for one reason or another below an exemption limit...?—The 6 million we have heard about?

131. Yes, exactly. All those people who at present do not pay income tax, are going to have to pay 4s. in the pound or whatever it is: is it not the case so far as all those people are concerned that it is going to have a very considerable disincentive effect which can only be matched up by this gain you might get on the margin of unemployment?—The average income today is about £6 or £7, is it not? So that we are getting the great bulk of wage-earners going over into the high levels of tax, or they will be, as wages rise very shortly. It seems to me there is a very small margin of people to whom your point is applicable, if you take insurance into account as well.

132. It is the case that in 1946, say, they were a considerably larger proportion of the population than they are now. The Government was very careful to see that at the very first opportunity they got the proposition down.—It was so wrong; exactly like giving a cash allowance to bachelors. Nothing could have been more immoral, unsocial, I meant.

133. Why?—Because if there was that amount to give away, it should have been given in much more social ways.

134. Is not the advantage of not discouraging people to earn more when they have the opportunity a very important one?—I am frightfully keen on not discouraging them, but to give it all away largely to single people meant that they started to live at the higher rate where the married people cannot catch them up. That is the way to get inflation, when you make the single people able to live at a higher rate than before, have their television sets and all the rest of it. It does start off the inflationary spiral.

135. You are surely not suggesting that these 6 million are mostly single?—A large percentage of them are. I am sorry, I am not prepared to argue it exactly, but the married proportion with children is quite small.

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LADY RITA WILLIAMS, D.B.E.

[Continued]

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MINUTES OF EVIDENCE

TAKEN BEFORE THE

2

ROYAL COMMISSION ON
THE TAXATION OF
PROFITS AND INCOME

SECOND DAY

Friday, 22nd June, 1951

WITNESSES

MR. A. T. HAYNES, F.I.A., F.F.A.
MR. R. J. KIRTON, M.A., F.I.A.
SIR ARTHUR COMYNS CARE, K.C.
MR. GUY NAYLOR
MRS. GUY NAYLOR
MR. ALAN PEACOCK, D.S.C., M.C.
MISS NANCY SEEAR

}
The Liberal Party

Questions
209-371

Questions
372-397



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1952

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64

TERMS OF REFERENCE

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages; to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer; to consider the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden fairly among the individual members of the community; and to make recommendations consistent with maintaining the same total yield of the existing duties in relation to the national income."

NOTE

For the guidance of intending witnesses the Commission published a list of the main heads under which evidence was invited. They explained that the list was not necessarily exhaustive and that witnesses could put in evidence on questions not specifically mentioned, provided that they fell within the Commission's terms of reference. The list is reproduced below.

A. General social and economic questions

1. Is the present system of taxation satisfactory, or could it be improved, in relation to:—
 - (a) incentives,
 - (b) risk bearing,
 - (c) encouraging savings,
 - (d) the control of inflationary or deflationary tendencies,
 - (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment,
 - (f) its effect on the distribution of personal incomes,
 - (g) other economic and social objectives?

These questions can be considered in relation to the taxation of:—

- (i) salaries and wages (P.A.Y.E.),
- (ii) profits of businesses and self-employments,
- (iii) dividends and other sources of income.

2. Would it be advantageous to link Income Tax with social security payments and contributions?
3. Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

B. Particular matters

4. Is the taxation net drawn too widely or too narrowly in relation to:—
 - (a) the taxation of United Kingdom residents (companies or individuals) on overseas profits,
 - (b) the taxation of non-residents on United Kingdom profits,
 - (c) the definition of residence, etc.?
5. (a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particular—
 - (b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?
6. Is the basis of computing income from property under Schedules A and B satisfactory?
7. Should the present rules about deductions for outgoings and expenses be altered?
8. Are the provisions for relief in respect of double taxation satisfactory?
9. Should the present system of graduation by means of the exemption limit, personal allowances, reduced rate relief and Surtax be altered?
10. Should the existing differentiation between earned and unearned income be extended or reduced?
11. Are alterations necessary in the rules governing personal and other allowances?
12. Should the rules about the taxation of husband and wife be altered (a) as regards aggregation; (b) in any other respect?
13. Should P.A.Y.E. be altered or abolished?
14. Should the principle of deduction at source be extended or restricted?
15. Should the method of assessment to Surtax be altered, and in particular should it be deducted from salaries?
16. Are any alterations desirable in the system of administration and the functions of the various statutory bodies or persons connected with taxation?
17. Are any changes in the provisions against avoidance and evasion desirable?
18. Is any alteration necessary in the rules governing the taxation treatment of special classes of taxpayers (e.g., public corporations, co-operative societies, charities)?

THE ROYAL COMMISSION ON THE TAXATION OF PROFITS AND INCOME

SECOND DAY

Friday, 22nd June, 1951

PRESENT:

The Rt. Hon. Lord Justice COHEN (Chairman)

Mrs. Vera ANTEY, D.Sc.
Mr. W. S. CARRINGTON, F.C.A.
Mr. W. F. CRICK.
Sir HARRY GILL, J.P.
Mr. J. E. GREENWOOD.
Sir GREGORY HEYWORTH.
Mr. J. R. HICKS, F.B.A.

Mr. N. KALDOR.
Miss L. S. SUTHERLAND, C.B.E.
Mr. J. MILLARD TUCKER, K.C.
Mr. G. WOODCOCK.
Mr. E. R. BROOKES (Secretary).
Mr. D. G. DAYMOND (Assistant Secretary).

Mr. A. T. HAYNES, F.I.A., F.F.A. and Mr. R. J. KIRTON, M.A., F.I.A.; called and examined.

MEMORANDUM SUBMITTED BY MR. A. T. HAYNES, F.I.A., F.F.A. AND MR. R. J. KIRTON, M.A., F.I.A.

SUMMARY OF EVIDENCE

In our Memorandum of Evidence we suggest a substantial measure of co-ordination between the Income Tax and Social Security systems with a view to achieving simplicity, improving incentive, and removing anomalies.

We first propose the replacement of the present system of Income Tax reliefs in respect of wife and children and the present system of Family Allowances by an improved scheme of family allowances (untaxed). Next, we propose a simplified scheme of personal taxation involving a level rate of tax on all earnings and (possibly) a cash personal allowance. The proposed allowances would supersede, either partially or wholly, present Social Security benefits and allowances—while the simplified scheme of personal taxation would incorporate the present National Insurance contributions.

Our two proposals—the first being independent of the second—lead to our putting forward for consideration the following contrasted scales of tax and allowances:—

	(A)	(B)	(C)
Level Rate of Tax	3s. 0d. in £1 (15%)	4s. 4-8d. in £1 (22%)	6s. 8d. in £1 (34%)
Personal Allowance (per week) ...	Nil	9s. 3d.	26s. 0d.
Family Allowances:— (per week)			
Wife ...	7s. 6d.	8s. 6d.	16s. 0d.
First Child ...	5s. 0d.	7s. 6d.	10s. 0d.
Each Subsequent Child ...	10s. 0d.	11s. 3d.	7s. 6d.

The above scales are used for the purpose of illustration only; their effect, by way of conversion of "nominal income" into "spendable income," is compared with that of the present system in Tables III-VI.

These proposals would greatly simplify the present procedure for all wage earners and salary earners within the "reduced rate area"—a very large proportion of the total body of taxpayers. In Section VI we deal with the additional tax that would require to be charged in respect of higher incomes, and Tables VII-IX illustrate the combined effect of all our proposals.

Introduction

1. Aims of Evidence

In submitting this evidence, our aim is to suggest a substantial measure of co-ordination between the Income Tax and Social Security systems with a view to:—

- (i) simplifying the complex structure of personal Income Tax and achieving a most important saving of administrative and clerical manpower;

- (ii) improving the incentive to effort; and

- (iii) removing certain anomalies which arise from the combined operation of Income Tax and Social Security in their present forms.

2. Limits of Evidence

We propose, so far as possible, to limit our evidence to matters of general principle, and to confine ourselves to the main features of both Income Tax and Social Security. Thus, while certain more important points of detail will be considered in Section VII of this Memorandum, we shall omit all reference to such matters as "age allowance," life assurance relief, expenses, marginal adjustments, etc., and to the subsidiary benefits of Social Security. We would, however, emphasise two points. First, having in fact examined a number of the detailed problems that arise, we are satisfied that their solution would involve no matters of principle and that they would not present any great administrative difficulties. Secondly, we feel that in practice the introduction of refinements often involves a use of manpower in their administration out of all proportion to their importance.

3. Arrangement of Evidence

We propose to develop our evidence in the following sections:—

- I. To consider the interrelation of Income Tax and Social Security.
- II. To examine, with reference to family status, the present combined effect of the personal Income Tax and Social Security systems.
- III. To suggest, as a first measure of reform, an improved scheme of family allowances.
- IV. To suggest, as a second measure of reform, a simplified scheme of personal taxation, involving a level rate of tax on all earnings and (possibly) a cash personal allowance.
- V. To consider the combined effect of the two proposed measures of reform—the improved scheme of family allowances and the simplified scheme of personal taxation.
- VI. To consider the superstructure of additional tax which would require to be charged on higher earned incomes.
- VII. To consider various points of detail arising in connection with the proposed measures of reform.
- VIII. To consider various points of principle arising in connection with the proposed measures of reform.

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Various figures and scales will be introduced as we proceed with the development of our evidence, and Tables based thereon are appended to this Memorandum. We would emphasise, however, that it is the underlying principles to which we attach importance and that the figures are introduced only by way of illustration.

1. The Interrelation of Income Tax and Social Security

4. Personal Income Tax System

Income Tax used to be solely a means of collecting revenue and, as such, it was levied according to "capacity to pay." Hence the present system came into being with personal allowances to exempt from tax the lower ranges of income (no capacity to pay), with reduced rate relief to lighten the burden on the next layer of income (partial capacity to pay), and with Surtax as an additional levy on the highest incomes (exceptional capacity to pay)—the standard rate representing the proportionate charge to tax where capacity to pay is normal. This system of "progressive" taxation of personal incomes is generally accepted as fair and equitable—but, in its application to-day to a vastly increased body of taxpayers, it has become extremely cumbersome.

5. Income Tax and Social Security

While still a major source of revenue, Income Tax is now regarded also as an important means of re-distributing the national income—and, in particular, of converting the individual's gross income into his spendable income. In fulfilling this latter function, Income Tax is closely allied to Social Security. In this connection we may quote the following extract from a paper entitled "Income Tax in Relation to Social Security" which we submitted to the Institute of Actuaries on 14th May, 1943:—

"The Income Tax and Social Security systems control the financial relationship between the individual and the community by the creation, increase, or reduction of the income of the individual. Social Security benefits represent transfers from the community to the individual; Income Tax payments represent transfers from the individual to the community. The two systems are, however, not merely complementary; they tend to overlap. Social Security contributions are similar in effect to Income Tax payments, although different in form; the Income Tax system involves personal and family allowances (akin to Social Security benefits) granted by way of relief against taxation.

Thus the Income Tax and Social Security systems taken together effect a readjustment of the income of the individual; they operate to determine the purchasing power to be granted to the individual by virtue of:—

- (1) his nominal income—earned income or investment income;
- (2) his responsibilities—wife, children and other dependants;
- (3) his infirmities—sickness, unemployment or old age.

Purchasing power may be further taxed in the process of being used, but this depends on whether the individual chooses to apply his purchasing power so as to attract or to avoid such further taxation. Purchasing power may be supplemented by State provision of many kinds without specific payment, or below cost. The important point is, however, that the Income Tax and Social Security systems together translate nominal income into personal purchasing power at "price to consumer."

This inter-relationship of Income Tax and Social Security demands that the possibilities of close co-ordination be examined."

It may be noted that the present Social Security arrangements are not "funded" and do not involve "insurance" in the normal sense of the term. A's present contribution is transformed into B's present benefit—not into A's future benefit. In effect, therefore, the Social Security system, like the Income Tax system, is a process of redistribution of the national income—a means of translating nominal income into purchasing power.

6. The Present Complex Arrangements

We may illustrate the various steps by which nominal income is translated into purchasing power by taking as an example a married couple with two children. The husband is assumed to have a salary of £500 in the Income Tax year 1951-52 and the wife is assumed not to be gainfully occupied.

(i) A FAMILY ALLOWANCE of 5s. 0d. per week (£13 per annum) is granted in respect of the second child.

(ii) A CONTRIBUTION of 4s. 11d. per week (approximately £13 per annum) is levied under the National Insurance Scheme.

(iii) Income Tax is calculated as follows:—

Salary	£500
Add Family Allowance	13
	£513
Less part of National Insurance Contribution	8
	£505
Less "earned-income" relief	101
	£404
Less Personal Allowances—Married Couple	£190
Two Children	140
	£330
BALANCE OF INCOME SUBJECT TO TAX	£74
Tax on £50 at 3s. 0d. in £1	£7 10 0
Tax on £24 at 5s. 6d. in £1	6 12 0
TOTAL INCOME TAX	£14 2 0

Thus the annual spendable income becomes:—

Salary ("Nominal Income")	£500
Add Family Allowance	13
	£513
Less National Insurance Contribution	13
	£500
Less Income Tax	14
	£486
SPENDABLE INCOME ("PURCHASING POWER")	£486

In the result, by a series of operations involving the machinery of Family Allowances, National Insurance Contributions and Income Tax, the nominal income of £500 is reduced to a spendable income of £486. It is noteworthy that the full effects of the Family Allowance and of the National Insurance Contribution are to some extent offset by the former being subjected to tax and by the latter making for partial relief of tax. It may also be remarked that, in this example, the presence of the second child leads to three separate operations:—

- (a) Payment of a Family Allowance of £13 per annum;
- (b) Charge of tax on (a), representing £3 per annum;
- (c) Relief of Income Tax, amounting to £19 per annum.

This example may serve to illustrate the involved series of transactions which arise between the individual and the State in all such cases—often with very little net financial effect, but always with a considerable weight of detailed administrative work which falls not only upon the Government Departments concerned but also upon the individual and his employer.

II. Combined Effect of Income Tax and Social Security Systems

7. Conversion of "Nominal Income" into "Spendable Income"

In order to examine on broader lines the present combined effect of the Income Tax and Social Security systems we show in Table I the "spendable incomes" corresponding with "nominal incomes" ranging up to £1,500 per annum, both for single persons and for families of varying size. The "spendable income" is calculated

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in the same manner as in the example already quoted—by deducting from the nominal income both the National Insurance Contribution and Income Tax, and by adding any Family Allowance which may be due. Table I also shows in brackets at the top of each column the annual equivalents of the Social Security payments during periods of sickness or unemployment; these figures take account of the increases of benefit for children proposed in the National Insurance Bill now before Parliament*. Two features are immediately apparent from Table I:—

(i) The general pattern of redistribution of income is that, in the process of conversion into spendable income, the earnings of single persons and of small families are progressively diminished as their incomes increase—while, for the larger families, all but the higher incomes are augmented. This pattern must clearly be retained to accord with present-day social policy.

(ii) There is an obvious lack of incentive, especially for a married man, to earn a small income as an alternative to claiming unemployment benefit or sickness benefit (sickness not being a definable condition is often unnecessarily prolonged). This feature is considerably accentuated by the operation of P.A.Y.E., with its system of income tax refunds—a point to which further reference will be made in Section V of this Memorandum.

8. Variation According to Family Status

To obtain a clearer appreciation of the redistribution of income according to family status—the horizontal view of the figures in Table I—it is interesting to analyse the concessions at present allowed to families of varying size at different income levels. From Table I we can derive the additional spending power allowed on account of a wife and on account of each child. These figures are shown in Table II, in which this additional spendable income is expressed in the form of a weekly allowance—which is the cash equivalent of the present Income Tax allowances (if any) combined, in the case of second and subsequent children, with the present Family Allowance (after deduction of tax, if any). The immediate impression created by Table II is that there is a most irregular relationship between the amounts appearing in the successive columns at varying income levels. Thus, for the lowest incomes, the first child ranks far little or no allowance, whereas around the £400 level the first two children rank for higher allowances than subsequent children—and this happens again for an income of £700; between these two levels, for incomes of £500 and £600, the second and third children have the largest rewards. Finally, for the highest incomes, the allowance for the first child is 20 per cent. less than for all subsequent children—whereas, at the other extreme, when earnings fall due to sickness or unemployment, the first child's allowance is 33½ per cent. higher than for subsequent children. In general, the allowances increase with earnings, but it is impossible to detect any definite policy regarding the relationship between the amounts which should be allowed for 1st, 2nd, 3rd, and subsequent children. Viewing these results, one is forced to wonder whether the complex arrangements involved in the schemes of income tax reliefs and of family allowances in fact achieve any systematic plan for supplementing the incomes of families in relation to those of single persons. It would appear that an improved scheme of tax-free family allowances—to include the wife and the first child—would be more effective and very much simpler than the present combination of two separate systems of allowances. The improved family allowances would also replace, in whole or in part, the allowances at present provided under the National Insurance Scheme.

III. Improved Scheme of Family Allowances

9. Alternative Approaches

If this principle were accepted, the main point for consideration would be the choice of a suitable level for the weekly allowances under the improved system. Should it, for instance, be based upon:—

(a) the maximum combined allowances now granted to those with relatively high incomes as shown in the bottom line of Table II?

(b) the payments now made during sickness or unemployment as shown in the top line of Table II? or

(c) the general level of the combined allowances now granted in respect of incomes of around £500 per annum?

The choice of (a) is ruled out by its generosity to all those in the lower and middle income ranges and to those in receipt of sickness, unemployment or pension benefit—the cost clearly being excessive under present conditions. The choice of (b) is attractive from many points of view. There is an element of logic and tidiness in providing the same substance level of allowance for the wife and for each child in all circumstances—whether the husband is earning or is out of work; it should be noted, however, that while allowances on this scale, without further income tax relief, would halve the present concessions allowed at the higher income levels in respect of second and subsequent children, they would be distinctly generous (as compared with present standards) at the middle income levels for the wife and first child. The choice of (c) has the advantage of keeping the cost within more reasonable bounds; (c) deals no less favourably than at present with the majority of income-earners, although it leaves both the higher income groups and the recipients of social security benefits worse off than under existing arrangements—deficiencies which can, of course, be rectified by supplementary concessions in such cases.

10. Six Contrasted Scales

Taking all these considerations into account, we would suggest the following six contrasted scales of family allowances for consideration:—

Scale	Wife's Allowance	Children's Allowances	
		First Child	Each Subsequent Child
A ...	s. d. 7 6	s. d. 5 0	s. d. 10 0
B ...	8 6	7 6	11 3
C ...	16 0	10 0	7 6
D ...	7 6	10 0	5 0
E ...	9 0	5 0	9 0
F ...	10 0	10 0	7 6

These six scales illustrate possible variations in the absolute and relative amounts payable in respect of the wife and successive children. Their rationale is as follows:—

Scale A increases the present family allowance by 5s. 0d. for each child (including the first child) and by 7s. 6d. for the wife; this additional family allowance, together with the privilege of tax-exemption for the allowance as a whole, would replace the existing income tax reliefs for the wife and children.

Scale B exactly reproduces the present combined allowances for taxpayers whose incomes fall within the 5s. 6d. tax-area.

Scale C is based on the existing social security standard applicable during sickness and unemployment and would permit full co-ordination of family allowances (including the wife's allowance) with sickness and unemployment benefits which would then be payable at a uniform rate (26s. 0d. per week) irrespective of family status.

Scale D is a variation of Scale A, designed to meet the point of view that it is the arrival of the first child which creates the greatest financial need in most families.

Scale E is an attempt at extreme simplicity—an equal allowance for all beneficiaries; for a wife and two children it produces almost the same result as Scale B.

Scale F, being a less costly version of Scale C with a reduced allowance for the wife, would permit co-ordination of children's allowances with the National Insurance Scheme—while leaving the latter scheme to provide an additional 6s. 0d. for the wife as part of the husband's sickness or unemployment benefit.

11. Choice of Scale

The choice of scale would depend upon cost (which the Treasury can estimate much more precisely than we can on the limited out-of-date information available to us) and partly upon the views held as to the relationship which should exist between the allowances granted in

* National Insurance Act, 1951.

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respect of the wife, the first child and each successive child. Our plan is that these issues should be faced and that a systematic scheme of family allowances should be introduced—by way of extension of the present limited scheme and to replace, for the vast majority of taxpayers, the existing system of income tax allowances and also, in whole or in part, the allowances provided under the National Insurance Scheme. We have in mind that, for those with higher incomes, certain supplementary reliefs for family status should still be incorporated in the Income Tax system; further reference will be made to this in Section VI. We also recognise that the present Income Tax allowances for children, unlike the present family allowances, continue after age 16 during full-time education; this concession could, we feel, be met by a continuation of the improved family allowances in such circumstances—perhaps at a reduced rate.

IV. Simplified Scheme of Personal Taxation

12. Scale of Income Tax

If these recommendations regarding the segregation of income tax allowances are accepted, family status will cease to be a factor influencing the taxation of the lower and middle incomes. Since the concessions due to married men and to families of varying size will be made entirely by way of family allowances, all married men will be subject to the same scale of Income Tax as single persons. This measure of reform does not necessarily involve any change whatsoever in the basis of taxation of single persons which—for the lower and middle income ranges—could be applied in its present form to all taxpayers, whether single or married. We suggest, however, that—having taken the first step by removing all family allowances from the Income Tax system for these lower and middle income ranges—it becomes relatively easy to effect a complete simplification of the personal Income Tax system. We now propose to study the lines along which this second measure of reform might proceed.

13. Level Tax 3s. 6d. in £1—Basis (A)

Reverting to Table I, the column headed "Single Person" shows the "spendable income" remaining after deducting from the nominal income both National Insurance contribution and Income Tax; this column—increased, of course, by the improved family allowances—would apply to all taxpayers if our first measure of reform were adopted. Ignoring for the moment the top entry in this column, which shows the Social Security benefits payable when income falls owing to sickness or unemployment, it is interesting to note that the general run of the figures for "spendable income" corresponding to nominal incomes up to £450 per annum can be quite closely reproduced by the simple expedient of charging a level tax of 3s. 6d. in £1 (15 per cent.) on salaries and wages, granting no personal allowance and abolishing the National Insurance contribution. The effect of this somewhat drastic simplification of procedure is shown in column (3) of Table III, from which it will be seen that the deviations from the present position never amount to as much as 5s. 0d. per week until an income of £450 per annum is passed. The "fit" is not exact, and the reduction of spendable income for the lower wage earners may be open to criticism (although this reduction will, in most cases, be more than compensated for married men by their increased family allowances) but the question immediately arises whether the differences overall are worth all the complexity of the present Income Tax system and the added labour of collecting National Insurance contributions. We have in mind that a supplementary tax structure would be required, and can easily be designed, for the relatively small number of taxpayers in the higher income ranges. By means of this Additional Tax (to which further reference is made in Section VI of this Memorandum) the "spendable incomes" shown in italics in column (3) of Table III could be made to approximate to those produced by the present system.

14. Level Tax 4s. 4½d. in £1—Basis (B)

As an alternative to the "3s. 6d. in £1" basis put forward in the preceding paragraph, and with a view to improving the position of the lower wage earners, the level

rate of tax on all salaries and wages could be increased to 4s. 4½d. in £1 (22 per cent.) and a cash personal allowance of 9s. 9d. per week could be granted to the individual in his own right—that is, apart from any family allowances which may be payable on account of his wife and children. The effect of this proposal is shown in column (4) of Table III, from which it will be seen that the "fit" for nominal incomes of £200 to £450 per annum (covering a high proportion of wage earners) is absolutely exact; the rate of tax and the amount of the cash allowance have been chosen with this end in view. The present National Insurance benefit would be diminished by 9s. 9d. per week—the amount of the cash personal allowance—in the same manner as has already been suggested for offsetting the improved family allowances against the allowances at present provided under the National Insurance Scheme. A supplementary tax structure would again be required for the higher incomes and would lead to an exact reconciliation with the present position for all "spendable incomes" shown in italics in column (4) of Table III.

15. Level Tax 6s. 8d. in £1—Basis (C)

Once the idea of a cash personal allowance is introduced, many variations of the rate of tax and of the amount of the cash allowance are obviously possible. To illustrate one such possibility, we show in column (5) of Table III the effect of a level rate of tax of 6s. 8d. in £1 (33½ per cent.) and an allowance of 26s. 0d. per week. This basis provides an allowance on full Social Security standards and, taken together with Basis (C) for Family Allowances (see Section III), would entirely supersede the present National Insurance benefits during sickness, unemployment and retirement (subject, however, to the increases proposed in the present National Insurance Bill). This basis, as already stated, is logical and tidy in that the same subsistence level of allowances would be payable in all circumstances—whether the individual is earning or is out of work—but it would almost certainly involve a net loss to the Exchequer and is open to criticism on the grounds that a level rate of tax of 6s. 8d. in £1 on all earnings is damaging to incentive. These are matters on which the Royal Commission will have other sources of information. Our purpose in giving this example of a particular case of the simplified scheme of personal taxation is only to illustrate the possibility of securing full co-ordination of Income Tax allowances with Social Security benefits in the process of simplifying the present machinery of personal Income Tax. It may be noted that this basis suggests all "nominal incomes" up to £200 per annum, and that it gives only a rough overall "fit"—which extends, however, to the higher incomes and would not necessitate a supplementary tax structure.

V. Combined Effect of Improved Family Allowances and Simplified Scheme of Personal Taxation

16. Three selected bases

In the foregoing sections of this Memorandum we have suggested that an improved scheme of family allowances should not only replace the present limited Family Allowances Scheme, but should also supersede the existing Income Tax allowances for both wife and children and, either partially or wholly, the present National Insurance benefits for these dependents. We have also suggested that the personal Income Tax system, stripped of the allowances for wife and children, should be simplified for the lower and middle income groups by charging a level rate of tax on all earnings and (possibly) by granting a cash personal allowance. Both for the improved family allowances and for the simplified Income Tax system we have suggested a number of alternative bases which might be adopted within the framework of our recommendations—and there are obviously many other alternatives available. It is difficult, therefore, to provide a comprehensive view of the combined effect of our two measures of reform on families of varying size, since this effect must obviously depend to a very large extent on the precise amounts selected both for the allowances and for the level rate of tax to be charged on all earnings. By way of example, however, we have linked the three bases of taxation illustrated in Section IV with the family allowances suggested in Scales A, B and C (see Section III), and we

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show in Tables IV-VI a comparison, for families of varying size, of the effect of each of these three bases with that of the present Income Tax and Social Security systems as reflected in Table I. The three selected bases, which are chosen only for purposes of illustration, are thus:—

	(A)	(B)	(C)
Level Rate of Tax	3s. 6d. in £1 (15%)	4s. 4.8d. in £1 (22%)	6s. 8d. in £1 (34%)
Personal Allowance (per week)	Nil	9s. 9d.	25s. 0d.
Family Allowance— (per week)			
Wife ...	7s. 6d.	8s. 6d.	16s. 0d.
First Child ...	5s. 0d.	7s. 6d.	10s. 0d.
Each Subsequent Child ...	10s. 0d.	11s. 3d.	7s. 6d.

17. Comparison with Present Position

Viewing the results in Tables IV-VI, it is at once apparent that, in comparison with the present position, the general effect of our two suggested reforms, when taken together, is to benefit the lower income earners—especially those with the larger families. This, of course, results mainly from our first measure of reform—the grant of a uniform cash allowance for the wife and each child irrespective of income. It may also be observed that under Basis (B) an exact “fit” is always achieved over the wide range of incomes which, allowing for family status, are at present subject to a maximum rate of tax of 5s. 6d. in £1. Under Basis (A) a close “fit” is obtained over a similar, but slightly lower, range of incomes. Above these income ranges, both for Basis (A) and Basis (B), the “spendable incomes” shown in italics in Tables IV-VI would be made to approximate to the present position by means of the Additional Tax on higher incomes, to which reference will be made in Section VI of this Memorandum. Basis (C) gives a relatively poor “fit” which, however, extends up to the surtax level without any need of a superstructure of additional tax on higher incomes. Basis (C) is, of course, designed for simplicity and not for “fit”—to illustrate the possibility of securing full co-ordination of Income Tax allowances, Family Allowances and National Insurance benefits. These specimen bases are capable of variation in many respects. Thus, for any given marital status, the general level of the “spendable incomes” can be changed by altering the amount of the cash allowance while the gradient of the “spendable incomes” can be changed by an appropriate alteration in the level rate of tax.

18. The Gap between Income Tax and Social Security

In the preceding paragraph, attention has been directed to the benefit conferred upon the lower income earners—especially those with the larger families—by our two measures of reform. This is a definite point of principle underlying our recommendations and is the only possible corrective to the anomalies and inequities disclosed in Table II. There is, in fact, at present an area of hardship which our recommendations would overcome, extending up to the income level (varying according to family status) where Income Tax allowances take effect. This area of hardship represents a gap in the present structure of Income Tax and Social Security and to close the gap, either wholly or partially, must involve expense. On the other hand, there appears to us to be also an overlap of the present systems, where National Insurance benefits and Income Tax allowances are both available at one and the same time, and our proposals would remove this overlap—thus offsetting, to an extent which we cannot measure with any accuracy but which will clearly depend upon the level of tax and allowances selected, the cost of closing the gap.

19. The Overlap of Income Tax and Social Security

To explain the overlap, we may instance the case of a married couple with one child, the husband earning £8 10s. 0d. per week and the wife not gainfully occupied. Let us assume that, towards the end of the fiscal year, the husband falls sick or becomes unemployed for a period of several weeks. Under the present P.A.Y.E. system, a tax refund of £1 10s. 0d. per week is allowed in addition to the National Insurance benefit of £2 12s. 0d.

per week—providing a total spendable income of £4 2s. 0d. per week. This compares with a spendable income of £7 18s. 0d. per week while at work and represents a reduction of only £3 16s. 0d. per week. The fact that, in this and many other cases, the spendable weekly income during periods of absence from work is a fairly high proportion of the spendable income resulting from a full week's work, raises serious questions affecting the incentive to effort. This position is, of course, due to the presence of these two sources of income—Social Security benefits and Income Tax refunds—during periods of sickness and unemployment. The fact that the Income Tax refund consists of the cash equivalent of a week's income tax allowances which, as we have already suggested, are similar in character to Social Security benefits, leads to the view that the present duplication of allowances represents an overlap between the Income Tax and Social Security systems. This overlap is removed by the proposals which we have made for an improved scheme of Family Allowances and (possibly) a cash personal allowance to be payable in all circumstances, together with correspondingly reduced National Insurance benefits in the event of sickness or unemployment. It is the elimination of this overlap which, we believe, would off-set to some extent the cost of closing the gap for the lower income earners.

VI. Taxation of Higher Earned Incomes

20. Necessity for Tax Superstructure

It has already been seen that, if the Income Tax system were reformed on the lines which we have suggested in Section IV, and if the rates of tax and cash allowances were designed (as in Basis (A) and (B)) to reproduce the present position for the middle income groups, a superstructure of tax would be required on higher incomes. Thus Basis (A) and (B) cease to give a reasonably close fit around the following income levels, at which levels the superstructure would need to come into operation:—

	Basis (A)	Basis (B)
Single Person ...	£ 430	£ 460
Married Couple:—		
No Children ...	520	560
1 Child ...	585	645
2 Children ...	650	720
3 Children ...	715	795
4 Children ...	780	870

No superstructure of additional tax would be required in conjunction with Basis (C).

21. Proposed Basis of Additional Tax

We would therefore suggest that an additional tax should be charged on any excess of earned income over the above-mentioned levels for Basis (A) and for Basis (B)—but not for Basis (C). To approximate to the present position, the additional rate of tax should be:—

Basis (A).—4s. 7.3d. in £1 (23%).

Basis (B).—3s. 2.4d. in £1 (16%).

Tables VII and VIII show, for Basis (A) and Basis (B) respectively, a complete picture of the combined effect of all our proposals—improved family allowances, the simplified scheme of personal taxation and the additional tax on higher earned incomes. Table IX shows a similar picture for Basis (C), although in this case no additional tax is involved. From Tables VII and VIII it will be seen that the proposed additional tax on higher incomes would extend up to the surtax level the close fit already established for the lower and middle income groups. We would, however, direct attention to the fact that for single persons this close fit is only achieved by bringing the additional tax into operation at a relatively low income level—£430 per annum for Basis (A) or £460 per annum for Basis (B). It occurs to us that some concession might be worth while to keep this lower limit of additional taxation above normal wage levels.

22. Assessment and Collection of Additional Tax

The additional tax on higher incomes would, of course, apply to only a relatively small proportion of the whole body of taxpayers now subject to P.A.Y.E. If thought desirable, it could be assessed on current earnings and

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collected by a simple P.A.Y.E. system. There is, however, much to be said for the additional tax being assessed and collected on a "past-year basis." The reasons which prompted the introduction of P.A.Y.E. do not apply in the same degree to an additional tax levied on excess incomes belonging mainly to salary earners. The convenience of a "past-year basis" and the incentive which it gives to "earn the money to pay the tax on the past year's earnings" make the idea attractive. Since individual assessments would be required for these higher incomes—either to determine the "coding" for P.A.Y.E. or to determine the tax on the past year's earnings—the question arises whether the additional tax might not be merged with the present surtax machinery and applied in one operation. These questions of detail do not affect the principle underlying our recommendations, but we have mentioned them in order to show that they involve no insuperable difficulty.

VII. Points of Detail arising in connection with the Proposed Measures of Reform

23. Payment of Allowances and Collection of Income Tax

Our first measure of reform involves an improved scheme of family allowances—to include the wife and the first child in addition to the second and subsequent children who are covered by the present Family Allowances Scheme. Our second measure of reform—the simplified scheme of personal taxation—involves (except under Basis (A)) a personal cash allowance to the individual in his own right and apart from his family responsibilities. The existing machinery for payment of family allowances could easily be extended to provide both the personal allowance and the improved family allowances—either by way of combined vouchers for the total weekly amount due in respect of the family as a whole or by way of separate vouchers for each member individually. From an administrative point of view, a scheme of equal allowances of, say, 9s. 6d. per week for all beneficiaries (i.e., Scale E of Family Allowances combined with a personal allowance of 9s. 6d. per week) would be a great convenience, since every man, woman and child would then be entitled to an identical set of coupons without enquiry as to relationship or dependency. As to the channel of payment of the allowances, we would suggest that the vouchers should be available:—

- (a) at a Post Office or at a local office of the Ministry of National Insurance;
- (b) by payment into the individual's bank account; or
- (c) by inclusion in the individual's wage or salary payments—the vouchers being deposited with the employer.

Tax at the appropriate level rate on all earnings would be deducted at source by the employer (a very simple operation), and would be remitted to the Collector of Taxes at suitable intervals. If this procedure of tax deduction were combined with method (c) for the payment of allowances, the apparent contents of the wage packet would not be depleted in relation to their present size—a point of some psychological importance. The burden falling on the employer, incidentally, would be very much less than that now incurred in connection with P.A.Y.E. and National Insurance contributions.

24. Dependent Relatives

The present Income Tax system provides certain specified allowances in respect of dependent relatives, housekeepers, etc. In such cases an income allowance of £50 is granted subject to certain qualifications—the cash equivalent being 5s. 4d. per week to a taxpayer subject to tax at a maximum of 5s. 6d. in £1. Under our simplified scheme, the position of these dependants would vary according to the basis adopted. Thus, under Basis (A), which provides no personal cash allowance, a dependant's allowance of 5s. 6d. per week might be added to the scheme of family allowances. Under Basis (B), each dependant would be entitled, in his own right, to a personal cash allowance of 9s. 9d. per week, and no question of a dependant's allowance need arise. Under Basis (C), the dependant would be entitled to a personal cash allowance of 26s. 0d. per week—thus illustrating the fact, to which we have already referred, that Basis (C)

is essentially generous to all those who at present are entitled neither to Social Security benefits nor to the full effect of their own personal allowances under the Income Tax system. It will be seen, therefore, that—whatever basis of tax and allowances were adopted—the position of the dependent relative could readily be met within the general structure of the improved family allowances. Similarly, no difficulty would arise in providing further relief for the dependent relative in the superstructure of additional tax on higher incomes.

25. The Wife's Earnings

Under the present Income Tax system, the allowance to a married couple is increased if the wife is gainfully occupied. This increase is evidently intended to restore the incentive to effort on the part of the wife, where otherwise the joint assessment of husband and wife would impair this incentive. In effect, the wife's earnings are assessed on a "single person" basis, leaving the husband with the full married couple's allowance—subject only to a joint upper limit of earned income relief. Whether this incentive for a wife to continue at work rather than to take care of her home and children is desirable is a question on which social and economic considerations are probably at variance. It is interesting to observe that, in the National Insurance Scheme, the treatment is reversed—the husband's benefit is reduced to a "single person" basis of 16s. 0d. per week if the wife is gainfully occupied. There is obviously need for a clear-cut decision on the provision which should be made for the "earning wife." Whatever this decision may be, there should be no difficulty in fitting the desired provision into our general structure of improved family allowances and simplified taxation. Thus, for example, under Basis (A), the wife might be permitted to retain her allowance of 7s. 6d. per week when earning on her own account, and be taxed at a level rate of 3s. 9d. in £1 on her earnings; for the purpose of the superstructure of tax on higher incomes, the husband could be treated as a married man and the wife could be treated as a single person. Under Basis (B), the wife could rank, while gainfully occupied, for the personal allowance of 9s. 9d. per week (within the limits of tax deducted from her earnings) in addition to the wife's allowance of 5s. 6d. per week and her income could be taxed in the usual manner. The result in both cases would be, in effect, to reproduce the present very favourable position. These examples, however, point to a possible compromise between the social and economic considerations to which reference has already been made—that, in all circumstances, the wife's allowance should be identical with the single person's allowance and that, for the purposes of additional tax on higher incomes, a married couple should be given the option of assessment as two single persons. Thus neither the scheme of allowances nor the superstructure of additional tax would exercise any influence upon the wife's decision whether or not to work for reward.

26. Investment Income

The main purpose of our second measure of reform—the simplified scheme of personal taxation—is to improve the system of taxation of wages and salaries, but the treatment of investment income would necessarily be affected by our proposals. The clearest case, for purposes of illustration, is Basis (B) which approximates very closely to the present position in its effects upon earned incomes at all but the lowest levels. To extend Basis (B) to investment income is relatively easy—assuming that tax would continue to be deducted at source at the full standard rate. Bearing in mind that the proposed cash personal allowance and the improved family allowances replace both family allowances and income tax allowances for all those who are now subject to tax at not more than 5s. 6d. in £1, investment income in such cases would rank for repayment of tax at a level rate of 4s. 0d. in £1. Under Basis (A), tax would again be deducted at source at the full standard rate; for incomes not subject to the full rate of tax, an appropriate scale of taxation of investment income (independent of family status) would have to be devised, and repayment would be made of the tax over-deducted. For the higher incomes, under both Basis (A) and Basis (B), individual assessments would still be required and provision for proper treatment of investment income could readily be devised in conjunction with the superstructure of additional tax on earned income. Under

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Basis (C), which re-graduates the whole tax structure up to the startax level, a uniform rate of 8s. 4d. in £1 could be applied to all investment income, being deducted at source, and no question of repayment would arise. We are not, of course, expressing any view upon the broader question of the relationship between the levels of taxation which should apply respectively to earned and investment income; for present purposes we have assumed that this relationship will remain unchanged. So far as procedure is concerned, it is important to note that, whichever basis were adopted, no enquiry need be made (except for startax purposes) regarding investment income unless a repayment claim is made.

27. National Insurance Contributions

In this Memorandum we have assumed, for convenience, that the employee's contribution to National Insurance is 4s. 11d. per week—the rate at present payable by adult male employed persons. In practice this contribution varies as between various categories of insured persons. If the principle is accepted that National Insurance contributions, being in effect a form of taxation, should be merged in the general structure of personal taxation, these present variations in contributions are relatively unimportant. If, on the other hand, it is felt that these distinctions should remain and that the present system of National Insurance contributions should be continued, our main argument would be unaffected—subject to appropriate adjustments of the cash personal allowances incorporated in the various bases which we have put forward in this Memorandum. We have assumed that the employer's contribution to National Insurance will be continued in its present form—and also the relevant portion of the contribution made by self-employed persons. These contributions we also regard as a form of taxation and, as such, they could of course be levied in many other ways in accordance with general fiscal policy.

VIII. Points of Principle arising in connection with Proposed Measures of Reform

28. Degree of Simplicity

From the national point of view we cannot emphasise too strongly the real loss of wealth and production that is caused by the waste of manpower in the operation of the present Income Tax and Social Security systems. This waste of manpower is both direct—through the administrative and clerical staffs employed by government departments and by employers—and indirect—through the time that every citizen spends to a greater or less extent in dealing with his own taxation and social security affairs. We are also concerned that a great many taxpayers have no understanding of the basis upon which their tax is computed; we feel that this element of unsatisfactoriness is a very bad feature of the present system and that many faulty assessments must remain unchallenged. We believe that our proposals would greatly simplify the present procedure for all wage and salary earners whose incomes are within the present reduced rate area—a very large proportion of the total body of taxpayers. From the illustrations which we have given it appears that extreme simplicity (as exemplified by Basis (C)) can be achieved only by a considerable re-arrangement of the present scheme of redistribution of personal incomes—in other words by a change in the pattern of social policy. A considerable degree of simplicity, however, can be attained without undue departure from the present position—especially after effect is given to what appears to be a desirable revision of concessions allowed to families of varying size. The degree of simplicity, in fact, depends upon the extent to which the Royal Commission is prepared to recommend the modification of the present structure. In general, we would plead that complications should only be retained if the adoption of a simpler procedure would create serious deviations from the desired pattern.

29. Incentive to Effort

In Section V of this Memorandum we pointed to the overlap between the existing Income Tax and Social Security arrangements as affecting the incentive to effort. The payments now made by way of Social Security benefits

and Income Tax refunds can provide a combined reward for idleness which seems in certain cases to represent too high a proportion of the reward for work. Even when no income tax refund is available, there is at present an obvious lack of incentive to earn a small income as an alternative to claiming unemployment benefit or sickness benefit. By our proposals, the position would be improved in all cases—the extreme case being Basis (C) which, in effect, entitles everyone to social security benefits at all times and, in addition, to two-thirds of whatever he may earn. Then, under Basis (C), additional earnings are always attractive and the incentive is maintained—subject, however, to our view that a basic rate of tax amounting to 6s. 8d. in £1 is too high. It is for this latter reason that we prefer either Basis (A) or Basis (B), despite the fact that these two bases do not effect so smooth a junction between what we have called “the reward for idleness” and the reward for a little work. The main improvement common to all three of our suggested bases is that the overlap would be removed and that payments made during sickness and unemployment would be restricted to Social Security standards—as was originally the case before P.A.Y.E. was introduced.

30. Tax and Allowances—The Choice of Basis

In the Tables appended to this Memorandum we have shown, by way of example, the effect of linking three particular scales of family allowances with three different bases of taxation. As we have already emphasised, these three bases have been selected only for purposes of illustration and an unlimited number of variations, both of the level rate of tax and of the amount of the cash allowances, could be adopted within the framework of our recommendations. If the general principles were accepted, the choice of basis would be influenced by many considerations such as simplicity of operation and effect upon incentive. With regard to simplicity, we would direct attention once again to the attraction of a uniform scale of allowances for every individual, payable in all circumstances and supplemented (to whatever extent may be necessary) by National Insurance benefits during sickness, unemployment and retirement. From the point of view of incentive, the main factor is that the level rate of tax should be kept as low as possible; it would seem likely on general grounds that a level rate of 3s. 0d. in £1 (as in Basis (A)) would have very little disincentive effect, but that a level rate of 6s. 8d. in £1 (as in Basis (C)) might impair the incentive to extra effort. We would, therefore, suggest that, if our two measures of reform were introduced together, the initial scheme of tax and allowances should be similar to that put forward in Basis (A)—possibly with an equation of family allowances at 7s. 6d. per week for all beneficiaries. In the light of experience, if it seemed desirable, these allowances might be raised (the level rate of tax being correspondingly increased) stage by stage to full social security standards—thus securing in due course their full co-ordination with National Insurance benefits. In our view, the possibility should be borne in mind that full co-ordination along the lines of Basis (C) may seem desirable at some future date and for this reason we would suggest that the initial framework should be such as might be capable of gradual extension towards an ultimate state of full co-ordination in the years to come.

Conclusion

31. Two Measures of Reform

To summarise our proposals, we have suggested two measures of reform affecting the Income Tax and Social Security system. By the first measure of reform, the whole range of family allowances embodied in the present Income Tax system would be superseded by an improved scheme of cash family allowances—which would, in effect, be an extension of the present limited Family Allowances Scheme. By the second measure of reform, the personal Income Tax system would be greatly simplified and could incorporate the insured persons' present contributions to National Insurance. By linking in this manner Income Tax with Social Security payments and contributions we believe that considerable advantages would be secured by achieving simplicity, improving incentive and removing anomalies arising from the combined operation of Income Tax and Social Security in their present forms.

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[Continued]

TABLE I

CONVERSION OF "NOMINAL INCOME" INTO "SPENDABLE INCOME"
(PRESENT SYSTEM)

Nominal Income (Gross Annual Salary or Wage)	Spendable Income					
	Single Person	Married Couple				
		Number of Children				
£	£ (68)	£ (100)	£ (135)	£ (155)	£ (174)	£ (194)
150	136	137	137	150	163	176
200	180	187	187	200	213	226
250	220	236	237	250	263	276
300	259	280	287	300	313	326
350	298	320	335	350	363	376
400	337	359	378	400	413	426
450	376	398	417	445	463	476
500	408	437	456	486	511	526
600	470	508	534	564	593	621
700	532	570	604	643	671	704
800	594	632	666	707	748	779
900	656	694	728	769	820	852
1,000	718	756	790	831	872	914
1,250	873	911	945	986	1,037	1,069
1,500	1,028	1,066	1,100	1,141	1,182	1,224

* The amounts shown in brackets at the top of each column are the annual equivalents of the Social Security payments (National Insurance Benefit and Family Allowance) during periods of sickness or unemployment.

TABLE II

COMBINED CARE ALLOWANCES PER WEEK UNDER PRESENT INCOME TAX SYSTEM AND FAMILY ALLOWANCE SCHEME

Gross Annual Salary or Wage	Wife's Allowance	Children's Allowances			
		1st Child	2nd Child	3rd Child	4th Child
£	£ s. d. (10 0)	£ s. d. (10 0)	£ s. d. (7 6)	£ s. d. (7 6)	£ s. d. (7 6)
150	0 2	—	5 0	5 0	5 0
200	2 6	—	5 0	5 0	5 0
250	6 3	0 2	5 0	5 0	5 0
300	8 2	2 6	5 0	5 0	5 0
350	8 6	5 8	5 10	5 0	5 0
400	8 6	7 5	8 3	5 0	5 0
450	8 6	7 5	10 7	6 11	5 0
500	11 1	7 5	11 4	9 7	5 10
600	16 7	10 0	11 4	11 4	10 7
700	16 7	12 9	14 8	11 4	11 4
800	16 7	12 9	15 11	15 11	11 8
900	16 7	12 9	15 11	15 11	15 11
1,000 and over	14 7	12 9	15 11	15 11	15 11

* The amounts shown in brackets at the top of each column are the Social Security payments (National Insurance Benefit and Family Allowance) during periods of sickness or unemployment.

TABLE III

EFFECT OF SIMPLIFIED SCHEME OF PERSONAL TAXATION
(* SINGLE PERSON * BASIS)

Note.—This Table does not include the effect of the proposed Additional Tax on higher incomes (see Section VI of the Memorandum). After deduction of this Additional Tax, the "spendable incomes" shown in italics in columns (3) and (4) would approximate to those produced by the present system as shown in column (2). No Additional Tax is proposed for Basis (C).

Nominal Income (Gross Annual Salary or Wage)	Spendable Income			
	Present System (see Table I)	Basis (A) Tax 3s. 6d. in £1 Allowance Nil	Basis (B) Tax 4s. 4-10d. in £1 Allowance 7s. 3d. p.w.	Basis (C) Tax 4s. 4-10d. in £1 Allowance 26s. 0d. p.w.
£	£ (68)	£ (—)	£ (25)	£ (68)
150	136	128	142	168
200	180	170	181	201
250	220	213	220	234
300	259	255	259	268
350	298	298	298	301
400	337	340	337	334
450	376	382	376	368
500	408	425	425	401
600	470	510	497	468
700	532	595	577	534
800	594	680	660	601
900	656	765	727	668
1,000	718	850	805	734
1,250	873	1,037	1,000	901
1,500	1,028	1,225	1,195	1,068

* The amount shown in brackets at the top of column (2) is the annual equivalent of the National Insurance Benefit payable during periods of sickness or unemployment. The corresponding amounts at the top of columns (3), (4) and (5) are the annual equivalents of the proposed weekly allowances.

TABLE IV

COMBINED EFFECT OF IMPROVED FAMILY ALLOWANCES
AND SIMPLIFIED SCHEME OF PERSONAL TAXATION

MARRIED COUPLE—NO CHILDREN

Note.—This Table does not include the effect of the proposed Additional Tax on higher incomes (see Section VI of the Memorandum). After deduction of this Additional Tax, the "spendable incomes" shown in italics in columns (3) and (4) would approximate to those produced by the present system as shown in column (2). No Additional Tax is proposed for Basis (C).

Nominal Income (Gross Annual Salary or Wage)	Spendable Income			
	Present System (see Table I)	Basis (A) Tax 3s. 6d. in £1 Allowance 7s. 3d. p.w.	Basis (B) Tax 4s. 4-10d. in £1 Allowance 12s. 3d. p.w.	Basis (C) Tax 4s. 4-10d. in £1 Allowance 26s. 0d. p.w.
£	£ (100)	£ (20)	£ (67)	£ (100)
150	137	147	164	209
200	187	190	203	243
250	236	232	242	276
300	280	275	281	309
350	320	317	320	343
400	359	360	359	376
450	398	402	398	409
500	437	445	437	443
600	508	520	513	509
700	579	615	597	576
800	650	700	671	643
900	694	785	749	709
1,000	756	870	827	776
1,250	911	1,082	1,022	943
1,500	1,066	1,295	1,217	1,109

* The amount shown in brackets at the top of column (2) is the annual equivalent of the National Insurance Benefit payable during periods of sickness or unemployment. The corresponding amounts at the top of columns (3), (4) and (5) are the annual equivalents of the proposed weekly allowances.

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[Continued]

TABLE V

COMBINED EFFECT OF IMPROVED FAMILY ALLOWANCES
AND SIMPLIFIED SCHEME OF PERSONAL TAXATION

MARRIED COUPLE—1 CHILD

Note.—This Table does not include the effect of the proposed Additional Tax on higher incomes (see Section VI of the Memorandum). After deduction of this Additional Tax, the "spendable income" shown in italics in columns (3) and (4) would approximate to those produced by the present system as shown in column (2). No Additional Tax is proposed for Basis (C).

Nominal Income (Gross Annual Salary or Wage)	Spendable Income			
	Present System (see Table I)	Basis (A) Tax 3s. 9d. 10s. 4d. Allowance 12s. 6d. p.w.	Basis (B) Tax 4s. 4d. 10s. 4d. Allowance 25s. 5d. p.w.	Basis (C) Tax 6s. 8d. 10s. 4d. Allowance 52s. 5d. p.w.
(1)	(2)	(3)	(4)	(5)
£	£	£	£	£
*	(135)	(33)	(67)	(115)
150	137	160	184	235
200	187	203	223	269
250	237	245	262	302
300	287	288	301	335
350	337	330	340	369
400	378	373	379	402
450	417	415	418	435
500	456	458	457	469
550	534	543	535	535
600	604	638	613	602
650	666	713	697	669
700	728	798	769	735
750	790	883	847	802
800	845	1,093	1,042	869
850	1,000	1,208	1,227	1,135

* The amount shown in brackets at the top of column (2) is the annual equivalent of the National Insurance Benefit payable during periods of sickness or unemployment. The corresponding amounts at the top of columns (3), (4) and (5) are the annual equivalents of the proposed weekly allowances.

TABLE VI

COMBINED EFFECT OF IMPROVED FAMILY ALLOWANCES
AND SIMPLIFIED SCHEME OF PERSONAL TAXATION

MARRIED COUPLE—3 CHILDREN

Note.—This Table does not include the effect of the proposed Additional Tax on higher incomes (see Section VI of the Memorandum). After deduction of this Additional Tax, the "spendable income" shown in italics in columns (3) and (4) would approximate to those produced by the present system as shown in column (2). No Additional Tax is proposed for Basis (C).

Nominal Income (Gross Annual Salary or Wage)	Spendable Income			
	Present System (see Table I)	Basis (A) Tax 3s. 9d. 10s. 4d. Allowance 12s. 6d. p.w.	Basis (B) Tax 4s. 4d. 10s. 4d. Allowance 25s. 5d. p.w.	Basis (C) Tax 6s. 8d. 10s. 4d. Allowance 52s. 5d. p.w.
(1)	(2)	(3)	(4)	(5)
£	£	£	£	£
*	(174)	(35)	(125)	(174)
150	163	222	242	276
200	213	255	281	308
250	263	297	320	341
300	313	340	359	374
350	363	382	398	408
400	413	425	437	441
450	463	467	476	476
500	511	509	515	508
550	563	553	563	576
600	611	600	611	641
650	746	763	749	708
700	810	839	827	774
750	872	915	905	841
800	1,027	1,147	1,100	1,008
850	1,182	1,269	1,295	1,174

* The amount shown in brackets at the top of column (2) is the annual equivalent of the Social Security payments (National Insurance Benefit and Family Allowance) during periods of sickness or unemployment. The corresponding amounts at the top of columns (3), (4) and (5) are the annual equivalents of the proposed weekly allowances.

TABLE VII

COMBINED EFFECT OF IMPROVED FAMILY ALLOWANCES, SIMPLIFIED SCHEME OF PERSONAL TAXATION
AND ADDITIONAL TAX ON HIGHER INCOME

BASIS (A)—Tax 3s. 9d. in £1

Note.—The amounts shown in brackets are the excess or deficit of the spendable income in comparison with those produced by the present system (see Table I).

Nominal Income (Gross Annual Salary or Wage)	Spendable Income					
	Single Person	Married Couple				
		Number of Children				
		0	1	2	3	4
£	£	£	£	£	£	£
150	128 (- 8)	147 (+10)	166 (+23)	186 (+36)	212 (+49)	238 (+62)
200	170 (-10)	190 (+3)	209 (+16)	229 (+29)	255 (+42)	281 (+55)
250	213 (-7)	233 (-4)	245 (+8)	271 (+21)	297 (+34)	323 (+47)
300	255 (-4)	275 (-2)	288 (+1)	314 (+14)	340 (+27)	366 (+40)
350	298 (0)	317 (-3)	330 (-3)	336 (+6)	362 (+19)	408 (+32)
400	340 (+3)	360 (+1)	373 (-3)	399 (-1)	425 (+12)	451 (+25)
450	378 (+2)	402 (+4)	415 (-3)	441 (-4)	467 (+4)	493 (+17)
500	409 (+1)	445 (+8)	458 (+2)	484 (-2)	510 (-1)	536 (+10)
550	471 (+1)	512 (+4)	540 (+6)	569 (+5)	595 (+2)	621 (0)
600	533 (+1)	574 (+4)	602 (-2)	642 (0)	680 (+2)	706 (+5)
650	595 (+1)	636 (+4)	664 (-3)	704 (-3)	745 (-3)	786 (+7)
700	657 (+1)	698 (+4)	726 (-2)	766 (-3)	807 (-3)	848 (-4)
750	719 (+1)	760 (+4)	788 (-2)	838 (-3)	869 (-3)	910 (-4)
800	784 (+1)	823 (+4)	843 (-2)	863 (-3)	1,024 (-3)	1,065 (-4)
850	1,029 (+1)	1,070 (+4)	1,098 (-2)	1,138 (-3)	1,179 (-3)	1,220 (-4)

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TABLE VIII
COMBINED EFFECT OF IMPROVED FAMILY ALLOWANCES, SIMPLIFIED SCHEME OF PERSONAL TAXATION
AND ADDITIONAL TAX ON HOUSEHOLD INCOME
BASE (B)—TAX 6s. 4-8d. in £1

Note.—The amounts shown in brackets are the excess or deficit of the spendable incomes in comparison with those produced by the present system (see Table I).

Nominal Income (Gross Annual Salary or Wage)	Spendable Income					
	Single Person	Married Couple				
		Number of Children				
		0	1	2	3	4
£	£	£	£	£	£	£
150	142 (+ 6)	164 (+27)	184 (+47)	215 (+63)	242 (+79)	272 (+96)
200	181 (+ 1)	203 (+16)	233 (+36)	252 (+52)	281 (+68)	311 (+83)
250	220 (0)	242 (+ 6)	262 (+25)	291 (+43)	320 (+57)	350 (+74)
300	259 (0)	281 (+ 1)	301 (+34)	330 (+30)	359 (+46)	389 (+63)
350	298 (0)	320 (0)	340 (+ 5)	369 (+19)	398 (+35)	428 (+52)
400	337 (0)	359 (0)	379 (+ 1)	408 (+ 8)	437 (+24)	467 (+41)
450	376 (0)	398 (0)	418 (+ 1)	447 (+ 2)	476 (+13)	506 (+30)
500	415 (0)	437 (0)	457 (+ 1)	486 (0)	515 (+ 4)	545 (+19)
600	470 (0)	506 (0)	535 (+ 1)	564 (0)	593 (0)	623 (+ 2)
700	532 (0)	570 (0)	604 (0)	643 (0)	671 (0)	701 (0)
800	594 (0)	632 (0)	666 (0)	707 (0)	746 (0)	779 (0)
900	656 (0)	694 (0)	728 (0)	749 (0)	810 (0)	852 (0)
1,000	718 (0)	756 (0)	790 (0)	831 (0)	872 (0)	914 (0)
1,250	873 (0)	911 (0)	945 (0)	986 (0)	1,027 (0)	1,069 (0)
1,500	1,028 (0)	1,066 (0)	1,100 (0)	1,141 (0)	1,182 (0)	1,224 (0)

TABLE IX
COMBINED EFFECT OF IMPROVED FAMILY ALLOWANCES, AND SIMPLIFIED SCHEME OF PERSONAL TAXATION
(NO ADDITIONAL TAX ON HOUSEHOLD INCOME)
BASE (C)—TAX 6s. 8d. in £1

Note.—The amounts shown in brackets are the excess or deficit of the spendable incomes in comparison with those produced by the present system (see Table I).

Nominal Income (Gross Annual Salary or Wage)	Spendable Income					
	Single Person	Married Couple				
		Number of Children				
		0	1	2	3	4
£	£	£	£	£	£	£
150	168 (+32)	209 (+72)	235 (+86)	255 (+105)	274 (+117)	294 (+118)
200	201 (+21)	243 (+46)	269 (+62)	288 (+ 88)	308 (+ 95)	327 (+101)
250	234 (+14)	276 (+40)	303 (+65)	321 (+ 71)	341 (+ 76)	360 (+ 84)
300	268 (+ 5)	309 (+29)	335 (+48)	355 (+ 55)	374 (+ 61)	394 (+ 68)
350	301 (+ 5)	343 (+23)	369 (+34)	388 (+ 38)	408 (+ 45)	427 (+ 51)
400	334 (+ 3)	376 (+17)	402 (+26)	421 (+ 21)	441 (+ 28)	460 (+ 34)
450	368 (+ 8)	409 (+11)	435 (+18)	455 (+ 16)	474 (+ 11)	494 (+ 18)
500	401 (+ 7)	443 (+ 6)	469 (+15)	488 (+ 2)	508 (+ 3)	527 (+ 1)
600	468 (+ 2)	509 (+ 1)	535 (+ 1)	555 (+ 9)	574 (+ 19)	594 (+ 27)
700	534 (+ 2)	576 (+ 6)	602 (+ 2)	623 (+ 21)	641 (+ 30)	660 (+ 41)
800	601 (+ 7)	643 (+11)	669 (+ 3)	688 (+ 19)	708 (+ 48)	727 (+ 52)
900	668 (+12)	709 (+15)	735 (+ 7)	755 (+ 16)	774 (+ 36)	794 (+ 58)
1,000	734 (+16)	776 (+20)	802 (+12)	821 (+ 10)	841 (+ 31)	860 (+ 54)
1,250	901 (+23)	943 (+32)	969 (+26)	988 (+ 2)	1,008 (+ 19)	1,027 (+ 42)
1,500	1,068 (+40)	1,109 (+48)	1,135 (+35)	1,155 (+ 14)	1,174 (+ 8)	1,194 (+ 30)

22 June 1951

MR. A. T. HAYNES, F.I.A., F.F.A., AND MR. R. I. KINTON, M.A., F.I.A.

(Continued)

EXAMINATION OF WITNESSES

209. Chairman: Before we commence the proceedings to-day, I want to make a statement, a copy of which will be handed to the Press representatives after I have read it. It is as follows:—

"It has been represented to us that one paragraph of our questionnaire may not have been fully understood in relation to capital gains. That paragraph reads as follows:—

5.—(a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particular—

(b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?

It should be read in conjunction with the answer given by the Chancellor of the Exchequer to a Question in the House of Commons on 6th February, 1951, as follows:—

Mr. Allen asked the Chancellor of the Exchequer whether he will enlarge the terms of reference of the Royal Commission on Taxation of incomes to include consideration of taxes on capital gains.

Mr. Gaittelli: The Royal Commission have been informed, in reply to an inquiry received from them, that their present terms of reference enable them to consider the question of charging to Income Tax or Profits Tax any profit ranking as a capital profit under the existing law which might reasonably be brought within the scope of those taxes."

Mr. Haynes and Mr. Kirtom, I think you have had a copy of the Board of Inland Revenue's memorandum* on the subject of your scheme and the other schemes of similar character, have you not?—Mr. Kirtom: Yes, Sir.

210. I will now put my questions to you conjointly and whichever of you you please, or both of you in turn, can answer them. Before I do so, is there any general statement you want to make before the members of the Commission address questions to you?—I do not think so, except on the Board of Inland Revenue's memorandum which does, of course, refer merely to a paper we wrote eight years ago.

211. Yes, certainly. Would you turn to paragraph 22 of the Board's memorandum? I do not know whether you agree with the description of the objectives that are there stated, as correctly summarizing the objects you had in view by your proposals. You may want either to modify or supplement.—I think they appear to be a reasonable paraphrase of the reasons given in our own first paragraph, namely, simplification, improvement of procedure, and the removal of anomalies.

212. Yes. In which of your tables is the effect of your (B) and (C) schemes stated?—The final effect?

213. Yes, I think it is Table III which I did in mind. As I read your Table III, if you take your (A) scheme, the lower class incomes suffer an appreciable loss of income—say you sitting in that chair, \$8, £10, £7 and come—to you sitting in that chair, the person whose spend-
\$4 may not seem much, but for the person who spends-
able income is £136 a year, £8 a year less would be
a serious matter, would it not?—Mr. HAYES: I think
that that point is admitted in paragraph 13, where we are
dealing With Basis (A). It is a point against Basis (A)
for the single person, but it is more than compensated,
for married couples with children, by the fact that the

214. Yes, I see. You got the married couple with one child, in Table V?—Table VII I think shows the position most clearly.

215. Yes, but even there there is a mist in against the single man with an income of up to \$350 a year and against a married couple with no children where the man's income is \$350 a year; after that it is better. Have you considered the cost of your various schemes, to the Treasury?—Sr. may I just interpose one comment there?

216. Yes?—I do not think we would altogether regard our various bases as being schemes. What we are really searching for is a simple way of doing the things which

income tax and social security are trying to do at the moment, to achieve roughly the same position, although, as we have said, the more simplicity one goes for the greater are the deviations from the present position, that one must admit. But our basis, as we call them, are only illustrations of different levels of benefit and different rates of tax, and I do not think we would regard them really as schemes; they are bases of approach to simpler schemes of achieving similar ends to those achieved at the moment.

217. The difficulty I feel in dealing with the matter is that we have, by our terms of reference, to frame our recommendations so that on balance the Exchequer does not lose, therefore before we can recommend any particular proposal we have to consider whether the effect of the change would bring more or less revenue to the Exchequer.—I think it is that there are really two questions: one is that we have searched for up-to-date statistics on which we might base estimates, but all the published statistics are so far out of date that they seem to us to be rather valueless, and we felt that the Treasury would be wiser to supply us with estimates of much greater value than anything we can produce. The second point is that we are going forward various lines by way of illustration: there are several bands of different scales of allowances and different levels of tax—there must be—which will produce exactly the same financial overall effect as at present, and we are not really suggesting anything that would involve a change in that overall effect. In other words, the rates of benefit and the rates of tax should be so fixed, presumably, that on the figures with which you were supplied by the Treasury the overall financial effect would be unchanged. That is really what we have in view.

218. If the result of that is that you have to have a higher rate of tax than the smaller income people at present pay, although it is true that they may ultimately get it back in benefit, may not the very imposition of a higher rate of tax have a disincentive effect on the workman's mind? It would take some time to educate him to see that he is approximately in the same position. That, of course, is viewing the tax as quite apart from the allowances. I think we suggest in our evidence that the allowances should be paid through the employer, and would therefore be set against the tax at the lower rate, and only the balance would be deducted from the gross pay.

219. One of the points which Lady Rhys Williams was stressing yesterday was that the woman should draw her own allowances and the children's allowance, whereas, if you carry out your suggestion, the father will have complete control, which might lead to disharmony in the home. I think that particular point is probably outside our scope.—*Mr. Kinnor*: The House of Commons, when debating family allowances, had a very long discussion on that. I believe.

230. I hope we shall not have quite as long a one today.—There is one point, if I might revert to the point you raised on the question of cost. It is true we have not made any estimates, because of the inadequate nature of the data, but if you look at Tables VII and VIII, you will see that the cost will arise obviously in respect of the pilot signs. From what information we were able to obtain—I think it was in the 52nd report of the Board of Inland Revenue—there are not a great number of families where the earnings are 24 a week and they have to support three children, for instance, and at a rough glance it did not appear the cost was a major order. But I do support, of course, Mr. Haynes' general point that the question can be struck off desired.

221. What I was a little afraid of was that when you tried to get the equation, so as to ensure that there was a benefit to the people you would probably be driven to a point where you would have to raise the rates on the Basic (C) and 6a. 8d. in the 2, as you say, might have a very discriminative effect?—We would agree with you entirely there, Sir, but I would have thought there was nothing here of a greater order than often occurs between one Budget and the next, due to either some change in personal allowances or reduced rate allowances, and the changes brought about in net incomes are rather changes of this order.

* Memorandum submitted by the Board of Inland Revenue is reproduced on pages 59 to 66 (Third Day).

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[Continued]

off as now and at the same time tries to avoid any substantial increase of cost, the effect is inevitably to keep literally and exactly to the present system. In other words, no change would be permitted on that basis.

237. Supposing one works out your Table VIII—and I cannot think Table VII is likely to be a practical proposition, it makes some of the poorer people worse off. Supposing the Board worked out figures on the basis of your Table VIII, and then, to find a rough equilibrium, if it were necessary to increase the tax in order to bring an additional revenue, it would inevitably follow of course that the benefits shown in the table would be affected, everybody would be paying more tax, including the persons shown there. That must be so, must it not?—Yes, Sir.

238. Mr. Carrington: Would your schemes necessitate the continuance of the coding system?—Only for what we call a superstructure of tax on higher incomes, that is, over £430 or £440 for a single man, and higher levels for married couples, and only then if the additional tax on these higher incomes were collected on a current year basis; we have rather suggested in our evidence that that additional tax should be on a past year basis.

239. How would you give effect to such matters as claims for building society interest, clothing and tool allowances and pension contributions? How would you give the taxpayer relief on those items of expenditure, if you do not code it?—I think in the first place we have rather regarded those so far, as we said earlier in the memorandum, as points of detail which, if the principle were accepted, we feel sure could be worked out, but in one or two cases we have explored the possibility. I think you mentioned first building society interest?

240. I mentioned that as an instance.—There are possibilities in certain cases of deductions at source, are there not? What we are dealing with on any of these bases on the general principle is a level rate of tax. A level rate of tax is very easily deductible at source from anything.

241. You are suggesting that the person paying building society interest should deduct tax at source?—Mr. Kirton: I do not see any objection to it, on the face of it.

242. How does he know, until the end of the year, how much interest is included in his monthly payments? As he pays it, the normal borrower from a building society pays composite sums, so much per month, and at the end of the year the building society provides a certificate splitting that figure between interest and capital. The Inland Revenue discharges the Schedule A assessment up to the amount of the interest, if there is an over-plus then that interest is given effect in the man's coding at the present time.—Mr. Haynes: If he has building society interest, he has also presumably got a Schedule A assessment, has he not?

243. Very often in the early stages in mortgage payments the interest exceeds Schedule A, and the balance is dealt with in the coding at the moment.—But could he not get relief then at the end of the year, by means of a certificate from the building society as to the amount of interest?

244. That would mean a definite repayment claim, would it not?—Yes, a straight one at a level rate of tax. There are no longer any allowances to be imported into it; the allowances are all aggregated.

245. Take the next two items I mentioned, pension contributions and allowances for clothing and tools.—Mr. Kirton: The allowance for clothing and tools is in the nature of a permitted expense, I take it that is really what it comes to. I speak in some ignorance of the detailed procedure, but surely that could be deducted by the employer from the wage, before deducting a level rate of tax. I take it the Revenue will accept the tool and clothing allowance statement of the employer.

246. But the employer, in order to keep himself straight with the Revenue and with the collector, would have to set surely on some notification from the Inland Revenue, he could not act in an arbitrary manner?—But the tool and clothing allowances are laid down as a matter of common practice are they not? I speak in ignorance, of course.

247. For members of certain trades I think they are, but Mr. Woodcock would know more about that. I think you would agree, however, that the employer would have to have some authority for making that allowance, would he not?—I would have thought, Sir, that the authority would have been a general authority, "For workmen of such and such categories, the tool and clothing allowance is X shillings a week", or what it is in fact.

248. What about the pension contributions, in those cases where employers have pension schemes to which workmen are contributing?—Mr. Haynes: I think that particular point is at present under review by a certain committee, if it not, the general question of pension fund contributions?

249. I am not speaking about the principle of it, I agree that is under review, but of the mechanics of giving the allowance on the existing scheme.—What I was really meaning was that there are obviously certain forms of relief for pension fund contributions which could be worked quite simply into this, it depends very much on the form of relief. But may I just make a point with regard, not so much to pension fund contributions but to many of the other smaller reliefs. I imagine the tools question would come into the category of smaller reliefs. These particular reliefs are of dimensions which are not really important in relation to the changes which might be made between a man's present position and a man's position if some such arrangement as this were adopted. What we have felt, I think, in considering these questions and preparing our evidence, is what we said at the end of paragraph 28, that complications should only be retained if they really do create a major effect on a man's taxation position. In other words, there is at the present moment an enormous machine for the collection of income tax, which must be costing an immense amount, not only in Government Departments but in every industrial organisation in the country, and incidentally taking up a great deal of time of private individuals as well. One wonders whether a large part of that cost and expense and labour is not really concerned with just these little things, and in relation to the amounts involved in these little things, whether the cost is not out of all proportion; in other words, should the details not be left to be fitted into the general structure as conveniently as may be, after the general structure is defined? I think that was what we felt.

250. My point was directed to this, that if you have to retain some form of relief at the time of payment of the wage, the employer granting that relief must act on an authority from the Inland Revenue, and that at present is the same thing as coding. The alternative to that presumably is a repayment claim at the end of the year by the workman or taxpayer concerned, and if you create a situation necessitating repayment claims at the end of the year are you going to clog the Inland Revenue machine and create a hold-up?—Mr. Kirton: I would not have thought that it was the same effect as coding. The employer and the Revenue both have a very simple, straight summation check; in other words, if the level rate of tax is 3s., and the wages total is £10,000, the employer has to account to the Inland Revenue for £1,500 tax, or diminished in fact by such clothing allowances or pension allowances he may have been authorised to deduct. The overall figure can be exactly checked at once by the Inland Revenue and the accountant. You get away from each man having a separate amount to be deducted and there being therefore no overall check. Your farmer can no longer pay his overtime gross, for instance, he has got to deduct his level tax and account for it.

251. That is assuming the farmer puts in accounts?—I am assuming, Sir, that Farmer Jones employs Brown, who really works for Farmer Smith, when it comes to a matter of overtime; therefore you do get an absolute check because if Farmer Jones says his wages bill is £5,000 he has got to present the Inland Revenue with £750 tax. You get away from coding entirely, you have a perfect overall check.

252. In effect you get down to a position, then, where wages charged in accounts are disallowable at the rate you have adopted for this scheme?—Yes.

253. Miss Sutherland: I just wanted a few points of detail. On this tax superstructure, if it has got to go down as low as I see it has got to go, to £430 or £440 income levels, do you think it is a good thing to abolish P.A.Y.E.?

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[Continued]

It would, I imagine, involve a very large number of taxpayers at about that level, would it not?—*Mr. Haynes*: Of course, the superstructure is only on additional income, therefore the amount involved even for a single man with £500 a year would be very low. In fact, we do raise the question, I think, in our evidence, merely with a view to simplicity, whether that £430 under Basis (A) should not be raised.

254. You would think on the whole, on your plea for simplicity, that it would be worthwhile taking out the lower superstructure groups and starting a bit higher?—*I* think so. *Mr. Kirton*: We could take an arbitrary figure of £10 a week, which is £520 a year. That is a point where it would not be worth going below.

255. *Mrs. Anstey*: I am rather worried by the effects on the married people with children, on the one hand, as contrasted with the social security payment. I think that is most clearly shown on Table VI, where one sees from the top line, if I understand this rightly, that the annual equivalent of the social security payments is not as high as the present system until you get to Basis (C); but, on the other hand, if you do take Basis (C) you find that all the people with £500 and up (this is all with three children, I know) these people with large families, from £500 upwards, all get a smaller spendable income than under the present system. This seems to me a dilemma. Either one has to give, for these married people with children, less social security benefits, if I have understood that rightly, or the somewhat higher middle ranges of the people get less spendable income. Have I understood that correctly?—*Mr. Haynes*: I think, Sir, *Mrs. Anstey* has perhaps understood those figures in brackets at the top of the table as being the entire benefits payable during the times of sickness and unemployment, but the £85 and the £125 under Basis (A) and (B) in brackets in that table are merely the weekly allowances which would be payable under these particular bases, but the intention is that they should be supplemented by social security benefits.

256. Until you get to (C) you have to have supplementation?—*Yes*, to bring them up.

257. But that of course is a disadvantage, is it not?—It means retaining the present machinery for paying social security benefits, whereas Basis (C), which has other disadvantages, would get rid of that.

258. But on Basis (A), of course, the lower income earner comes off worst, does he not—the single people at any rate—I think that is shown in another table?—*Mr. Kirton*: Table VII.

259. *Yes*. Have you anything to say about the position under (C) which does away with the supplementary allowances? Can you suggest any way in which one could remedy this state of affairs for the families with several children, at the £500 level upwards?—*Mr. Haynes*: I am afraid really the trouble with Basis (C) is that it is so drastic. It does achieve simplicity, but is drastic in that it gives the lower incomes very considerably more than at present, and somebody has to pay for that. The people who are paying for it are in this particular category, the married couple and three children. It is a very drastic re-gratification of the present position.

260. Of course, you have to have re-distribution, and I quite see somebody must lose and somebody else gain, but it seems to me that under these arrangements the people who lose are either the worse off or those with the children, just the classes of persons which I should like to benefit—is not that so?—*Mr. Kirton*: That is a true statement of the effect of Basis (C), but we are very conscious that that is a remote basis. It is so far away from the present distribution that it is put in purely to illustrate the point, rather than as a serious suggestion for immediate adoption.

261. However, you do lose the simplification on the others?—*Yes*, the developments over the last eight or nine years have been all away from simplification. *Mr. Haynes*: You lose some measure of simplicity.

262. *Mr. Hicks*: I take it that really the arguments against Basis (A) on the one hand and against Basis (C) on the other hand are in both cases pretty strong, and that therefore, while quite appreciating that these are all illustrative, it is really something in the neighbourhood of Basis (B) which we ought to be mainly looking at?—*I* do not think the arguments against Basis (A) are nearly so strong as against Basis (C). In fact there might be a

strong argument in favour of making a start with Basis (A), which is simple and involves a low rate of tax, which itself has a great advantage, of course. In other words, a wages tax of 3s. in the £ is probably acceptable; and Basis (A) also involves no allowance for the individual himself; it is really only a small extension of machinery from the present family allowances scheme, involving the first child and the wife.

263. It would of course mean that the whole of the unemployment side of the social security would have to go on more or less as at present?—*Yes*, providing smaller benefits and supplementary benefits.

264. The scheme itself would be of no use for that particular purpose under (A)?—*Mr. Kirton*: It would do away with the overlap, that is, it would do away with the refund of income tax.

265. *Yes*, quite. The other point I wanted to ask was the question of family allowances with regard to the higher income groups. In Table II it is shown very clearly, that the effective family allowance under the present income tax system rises as the income rises. In the most favourable cases, in the case of people with relatively large incomes and large families, it is a maximum of 15s. 11d. per child for certain children?—It includes 5s. family allowances.

266. *Yes*, quite, it includes the family allowance minus tax, does it not?—*Yes*.

267. But it seems to me that none of your schemes gives anything like that amount, is that right?—They do in fact, when combined with the superstructure of tax at that level.

268. *Yes*, I know, but they do not, as an allowance per child?—*No*.

269. They may mean that that family is perhaps better off?—*Yes*.

270. But they do not in fact give the allowance per child as high as it is at present is?—*Mr. Haynes*: The expense, of course, would be colossal. *Mr. Kirton*: If you take Table II, and you give a 15s. 11d. allowance to the man who has £200 a year and three children, the expense would be fantastic.

271. *Yes*, but what I am thinking of is the point which was made in the discussions of the Population Commission; I do not recall exactly what was in the Report, but the matter was discussed a great deal. The family allowances which were given to the middle class income group in relation to the present income tax were criticised as being inadequate. It seems to me that your scheme would be open to even greater criticism on those grounds?—*I* think the proof of the pudding, Sir, is in Tables VII and VIII, where, as you can see, if you take the man with £700 a year and two children, the effect must be to leave him very much the same as he is now. Our scheme might perfectly well increase the family allowance for children in the middle income groups, if it was desired, quite simply, but we have merely tried to reproduce the position.

272. But it would involve a considerable change of principle, would it not, if you are going to make family allowances in any way payable on income?—What level of income are you thinking of at the moment?

273. I was thinking of £700 to £1,000.—If you want to adjust the family allowance position there, if you turn to paragraph 20, all you have to do in that little table at the top would be to change the point at which the superstructure tax became payable for people with larger families.

274. You think that a family allowance should be considered in the super-tax?—If you were in the £700 to £1,000 a year group, that is how you would do it, if you wanted to.

275. I take it that the rather curious amount of the level rate of tax was calculated in order to equate a lot of incomes to those produced by the present system, the way they do in Table VIII?—That is all.

276. It does not imply any calculation of the cost of the scheme?—*No*, it is purely to produce the identity, to show that it could be done.

277. Produce the identity over a considerable part?—*Yes*, over a very wide range.

278. But if in fact it should turn out, as a result of calculations, that there was an appreciable net cost on that basis, it would mean the tax would have to be

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[Continued]

4s. 6d. or 4s. 8d.—*Mr. Haynes*: Yes, that might be the solution or other taxes might be raised. That is really a point that perhaps we should make. We do not seek to produce any equation between the yield of income tax and the cost of these allowances. In other words, we would regard the allowances as being purely a charge on the general fund of taxation, and if extra taxes are required it might be purchase tax or any form of tax, that would meet it.

279. *Mr. Keldor*: I just wanted to ask one or two questions. In your scheme the wife's allowance is really united to the present family allowance. I suppose the way you envisage it is that instead of family allowances being payable for the second and subsequent children, they would be payable to all children and for a wife?—Yes.

280. They are a form of cash allowances payable to anybody, irrespective of income. It would be possible, would it not, to make a wife's allowance rather in the way—I will not say the same way—you treat the personal allowance under your scheme (A). Do you think that would introduce a complication in your income tax system, to reduce tax liability in respect of a married man more than in comparison with a single one, either in the form of a flat reduction of the tax payable or a reduction of the percentage? I am just thinking that if we introduce an unconditional wife's allowance, in other words, extend the present family allowances to wives, that would imply a certain basic change in our existing system. I am not sure that that sort of thing would come within the terms of reference of this Commission. My question was, would you think that your simplification would be lost if the allowances to married persons were in some such form as under the present system? I am not saying, by present system that you give so much income tax free, £190 or something, but that you give reduced tax liability by a certain amount?—You are thinking of a lower rate of tax?

281. Either a lower rate of tax, or that you treat this allowance for the wife as a reduction of tax liability?—It is one step back, of course, to complexity, is it not? It is bound to be, it is creating a distinction again, which requires machinery to operate it.

282. You would have to introduce some sort of coding system?—*Mr. Kirton*: Reincorporating, by another means, an allowance for a wife in the tax system.

283. I think I entirely agree with what you say, that in principle your scheme does not need to involve any cost; the idea is to change the present system for giving income tax allowances and simplify the tax administration, and you could always work out a scheme that is not does not cost anything, but, as you say, you cannot work out a scheme that leaves every family the same as it was before. I suggest to you that the principal effect of any of your schemes would be—I do not think it is a bad one, I think it has something to commend it—to improve the position of large families as compared with small ones, in all income levels below a certain limit?—Yes, I agree.

284. That is a necessary effect of your scheme. Therefore, if you stick to the idea that the thing is not to cost anything, it would involve, would it not, a deterioration of the position either of single persons or persons with small families, or of families in higher income groups, depending on which sort of scheme you choose?—*Mr. Haynes*: There are two points, I think; one is the overlap.

285. Overlap saving?—Yes, which we cannot measure, but which we think is substantial, and the other point is one that Mr. Kirton has already mentioned, that there is probably quite a substantial amount of income at present going untaxed, which could be brought in by a level rate of tax. Those two things might go some way towards helping to meet the extra cost of helping the bigger families, and, of course, these bigger families with four children, where you get a substantial increase in spendable income under some of these bases, are relatively few. The concentration, the weight of taxpayers, is in a certain cross-section of the table where I do not think the differences are so great.

286. In your Scheme (A) you incorporate in effect the present personal allowance in the rate of tax itself, and I was very interested to see a somewhat surprising result,

the closeness of the fit which you get with a flat rate of tax of 3s. in every pound, with the present system. Going further with the same idea, one could, I suppose, give a wife's allowance and a children's allowance which, up to certain limits, would also be progressive, rather like the present earned income relief, where up to certain limits the tax liability is reduced by such and such a proportion?—Which really is the same as a lower rate of tax in such cases.

287. As a lower rate of tax up to certain maximum limits, instead of giving a fixed allowance. That would incorporate some progression in family allowances, I am not saying whether it is desirable or not.—It would re-impose some complications.

288. I take it, therefore, that you really feel that the simplification of your scheme is the thing above all to commend it?—I think we would like to make a fight for simplification, because complications so easily return, do they not?—*Mr. Kirton*: I think, Sir, one of the fundamental underlying worries we have is that the country simply cannot afford the manpower which is being used in the administration of all these complexities. I think that is our fundamental worry, that there is an immense amount of real wealth running to waste on account of a complex administration—and by that I mean not only Inland Revenue, and National Insurance, but also employers and private citizens, which, as far as we can see, is achieving very little.

289. May I just ask you one last question? I suppose, when you were thinking about this, you did not attempt to make even a very rough estimate of the saving of the cost of administration involved to the Government and business?—It is almost impossible to cost it.

290. I am not quite sure, everything can be done by some method.—Shall I say we have not found it possible?

291. You would not say anything of the order of magnitude?—No.

292. *Mr. Crick*: Would you agree with this statement, that in its simplest form your scheme, that is, the fusion of allowances for wives and children with family allowances, would have no effect whatever on the present machinery of the National Insurance Fund?—It is Basis (A) and Basis (B) you are speaking of?

293. No, I am speaking of (A).—It would affect the amounts involved. The benefits, so far as they apply to the wife and child, would be reduced by the amount of the allowances payable to everybody, so that the total would be the same.

294. But the allowances at present are not made out of the National Insurance Fund.—The National Insurance benefits would be reduced by the amount of the proposed allowances, so that the total payments per week during sickness or unemployment would be unchanged. Therefore the payments out of the fund would be less than at present. Of course, the National Insurance scheme now, as the Royal Commission is aware, is not funded; the fund is really only an account, it is a Government account, it is not a self-balancing fund as between contributions and payments. *Mr. Kirton*: There would be the further point that the employees' contributions would no longer be paid into this fund. That has been incorporated in the tax base.

295. But does that apply to Basis (A)?—Yes.

296. I found your memorandum rather ambiguous on that point, because you speak about the insured persons' contributions being incorporated, but in paragraph 27 I was not clear whether you proposed under your full scheme to abandon the machinery of the National Insurance Fund or to retain it. Perhaps you do not regard that as a necessary decision for you to make?—Surely the National Insurance Fund now is just a pool into which receipts are paid and out of which payments are made, the balance being met by a payment from the Exchequer?

297. Is it not rather more than that? It is a machinery for building up a reserve in the form of a vast holding of Government securities.—No, I think there is no fund being built up nowadays under the National Insurance scheme, not for pensions, anyway, or sickness. *Mr. Haynes*: No, the fund is accumulated for unemployment, is it not?

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[Continued]

298. But here we have the accounts of the National Insurance Fund and the National Insurance Reserve Fund together with a record of the holdings of Government securities in those funds.—Of course, the old funds, before the new scheme was introduced, were sealed off and the interest income from those funds is being used now as income to the new scheme. I think the general point is that surely this is pure accounting; the social security arrangements as a whole now, are really nothing but re-distribution of current year's income with some rather detailed accounting lying behind.

299. That was what I was going to dispute with you, as a matter of fact, because it does seem to me that under the present system we are in fact building up a growing reserve, which will of course no longer be built up under the present budget, but I take it you would not desire to cite as either a merit or a demerit of your scheme that it would or would not dispose of the National Insurance Fund. What I am getting at is whether you wish to put that in as an argument, or not?—No, I think quite definitely not. After all, exactly the same sort of building up of a fund could take place within the Budget itself, by creating a budget surplus.

300. You have assumed for the purpose of your calculations that the employers' contribution and the contributions of self-employed persons will be returned. Is that anything more than an assumption, or would you advocate that as part of your scheme?—I think on principle we would prefer to see all the contribution procedure as being another piece of machinery disposed of, but we did not feel very strongly on that point. Mr. Kirton: It is really in effect an employment tax in the hands of the employer. It is an added encouragement to use machines rather than men, and we would have thought the social implications were rather outside our terms of reference.

301. Mr. Woodcock: I have been looking at your aims in your evidence, and I wanted to confirm what I understood you to say in reply to Mr. Kaldor, that your main purpose is to simplify the complex structure of income tax, and that the other things are incidental to that? Your second aim, improving the incentive to effort, that is more incidental, you do not regard that as your main aim?—Mr. Haynes: Placed in order of magnitude, I think the first one would be the major aim. Mr. Kirton: I think so, but of course, in so far as the second one is concerned, disincentive again diminishes the real wealth of the country.

302. Even if this scheme of yours did not improve incentive, you would still think it worthwhile?—Yes.

303. In paragraph 5 you say "While still a major source of revenue, income tax is now regarded as an important means of redistributing the national income", but the income tax has a purpose additional to that, has it not, it has social purposes beyond securing revenue, beyond re-distributing incomes?—I think we meant, Sir, when we spoke about re-distributing income, that it has a social effect.

304. But other than merely re-distribution?—That is part of the social purpose, it is used as a social weapon through the re-distribution of income.

305. As I understand it, in this scheme of yours, as in similar schemes of this kind, it is implied that up to a certain level of income the tax is at a fixed sum per pound, replacing the present scales; therefore, taking your scheme and the table here in paragraph 20, a single person under Basis (A) earning up to £430 would pay . . .?—Mr. Haynes: Three shillings.

306. Yes. At the present time within that range there would be single persons who would be paying at 3s, 5s, 6d. and 9s. 6d.?—Mr. Kirton: Yes, I do not know if they do actually reach 9s. 6d.

307. Does not that introduce into your income tax system a degree of inflexibility compared with the present one?—Mr. Haynes: I think one can only go back to the effect of Basis (A) as shown in the tables, compared with the present system. I do not quite know what you mean by inflexibility.

308. Then I will put it this way: if you have to tax every pound of income at the same rate for each class, then in the case of a single person you no longer worry

about the size of his income up to that maximum, whatever it may be. But surely if a Chancellor is considering raising taxation, on your scheme the limit of his ability to raise it would be the limit of the ability of the lowest person of that group to pay the increase?—Mr. Kirton: I quite agree it obviously does, in achieving simplicity, diminish to a certain extent the degree of flexibility. The result, as Mr. Haynes has said, is shown in Table VII, which in our judgment is not really terribly substantial.

309. But your figures are nothing but illustrations of the effect?—Yes, but your point is that under the present machinery the Chancellor would widen the 3s. band or introduce a 3s. 6d. band, whereas under ours he would have to put it up from 3s. to 3s. 3d., but of course he could always, if he wished to do so, increase the allowances at the same time, which would offset the charge for the lowest incomes of all.

310. I agree, but surely the incentive that is claimed for schemes of this kind is that the workman is taxed at the same rate, but if you are going to adjust the allowances you do not have that effect on the rate of taxation, which therefore has no effect on incentive at all. The fact that a man gets a higher allowance does not affect the rate of tax or the amount of tax, therefore in considering whether to earn more or not it has no effect at all?—Mr. Haynes: Surely, if the Chancellor is considering an alteration in the rate of tax and he weighs up the question of altering the 2s. 6d. rate, the 5s. 6d. rate or the allowances at present, he must look at a table rather like Table I, and say "At present each income is reduced to so much, I want each case to be reduced to so much, which we will put down in the next column." I do agree with you that it would be not quite so easy to follow that set of figures that we would like to have for the future, with only the two variables of the level rate of tax and a level weekly allowance, as it would be with all the different rates of tax at the moment, but I think you could always get very close to it, just as we have found no difficulty in getting close to the present position by means of a level rate of tax and a level set of allowances. There seems no reason why, with any desired position in the future, the same two variables could not very closely reproduce whatever amount was desired.

311. I understood the argument to be that the disincentive in the present system in the rate of tax, apart from P.A.Y.E. itself, is that the marginal rate is higher than the other rate. Therefore if the Chancellor is concerned with incentive I thought the argument was that he could not achieve it because he could not reduce the marginal rate to anything near the average rate?—Mr. Kirton: If I may take this point of incentive just to clear my own mind. I think there are at least three aspects of it. First an absolute level of tax where it is 6s. 8d. on the first £ would be a serious disincentive. The second point is where a man working overtime suddenly finds himself lifted into a higher category, which I think is the point you are on now, and the third point is the disincentive to return to work owing to what we have called the overlap, the refund plus national insurance benefits. Our scheme deals with the last one. I do not think 3s. or something like that would be a disincentive. I would draw your attention to this; our super-structure tax we suggest should be payable in arrears. If a taxpayer breaks through into that then he has not that disincentive which now exists when he has suddenly come into the 9s. 6d. area and does not think his overtime worth working.

312. Up to a point he would substitute one rate for a series of rates. In other words, you are taxing people who have not been taxed before. To that extent, therefore, there is disincentive surely, so far as people are taxed who have not been taxed before?—Mr. Haynes: They will be getting a bigger pay packet if the employer cashes the allowances. We say here that there is a psychological value in having them cashed by the employer.

313. And up to that level the Chancellor would be more limited than he is now in increasing the different rates and the difference between the rates?—I think Mr. Kaldor mentioned this just now. We have been quite surprised in working out these figures at the flexibility you have just with these two constants. You can so nearly reproduce the results which are produced by the present method of graduated series of rates.

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MR. A. T. HAYNES, F.I.A., F.F.A. AND MR. R. J. KIRTON, M.A., F.I.A.

[Continued]

314. But you cannot do that if you substitute one rate for three rates?—It is really only two rates because when you get into the present full rate area you come into the superstructure, that is where the superstructure starts.

315. Taking your Basis (A) and this Table in paragraph 20, a single person up to £430 would be paying on three different rates, low rate, middle rate and high rate?—Mr. Kirton: If I may, I think the answer is in the figures in Table VII, where up to £430 for a single person under Basis (A) we admit the weakness. The worst deviation is minus £10 at £200. You do reproduce quite closely...—Mr. Haynes: I would challenge that statement that below £430 the full rate operates.—Mr. Kirton: I would not have expected it to, but I cannot speak from memory.—Mr. Haynes: There is at present a £250 reduced rate area, a reduced rate band, and that is after deducting the one-fifth earned income rate. That means about £310 for gross income. You have also the single man's personal allowance, I think it is about £625 for the single man when the full rate begins to operate.

316. That is only taking that as the figure. If it were higher there would be no doubt.—That being so, there are only two rates for which we are substituting the one rate, and the lower of those rates operates over a very small band and can almost be ignored.

317. That is again on the assumption that it will be limited in the case of a single man to those under £430. Mr. Carrington was asking what you would do about the other reliefs to which the man is entitled and I gathered from your replies that you hoped the employer would pay in effect or fail to deduct tax up to the amount of his reliefs. In that case surely the employer must, as Mr. Carrington said, have some notification: the employer must be authorised to make the repayment or fail to make the deduction?—Mr. Kirton: I say it with some diffidence, but I should have thought on things like tools and clothing relief it was a thing fixed by the Inland Revenue, that a worker in such and such category was allowed such and such amount for tools and clothing, and that a general authorisation should be given to the employer that that was the allowance.

318. Could they give a general authorisation for the employer to determine who was within that category? Surely someone would have to define the individual. First of all the definition of the category, in this case tool allowances, is done by the Union really and approved by the Inland Revenue, but the taxpayer has to be discovered in that group?—I speak subject to this being a point of detail, but I thought everybody was quite clearly defined by their Union as to their category and therefore the amount of such claims to which they were entitled.

319. I thought your suggestion was that the employer would say in effect—"I have allowed this man, or failed to deduct from this man, a certain sum of money because he is in a certain group."—I imagine that is determined between the Union and the employer, but I do not know. Mr. Chairman, might I refer to one point Mr. Kaldor asked?

320. Chairman: Certainly.—Mr. Kaldor asked if we could make an estimate of the saving of manpower, and the answer is no. We have however both been administering life offices for many years and we know something of that work and this use of tables and so on, and I think we would say we are satisfied it must be very substantial when spread over the whole country. We know with our skilled staffs the amount of manpower it takes for this type of general work.

321. I might put now a question I proposed to put at the end. It is true they are talking about the Liberal Party scheme, but the Inland Revenue seem to have taken a much more pessimistic view as to the effect of these schemes generally on administration, in their paragraph 19. I do not know whether you have got any criticism you want to make on that paragraph? I meant to put this question to you when I started, but I forgot.—They said there the saving to their own Department would be ten to fifteen thousand and there would be a substantial increase in the Ministry of National Insurance and they make no estimate of the saving to industry.

322. They take the view that any saving in their Department, or possibly in industry, would be offset by the labour that would be involved in administering the personal allowances which are common to your schemes.—I would not have thought so myself by any means.

323. There was one point in your answer, I forgot to whom, which made me doubt whether you were not optimistic in thinking there would be a saving in employers' offices. You propose to put on to the employer first of all the payment of personal allowances to employed persons and secondly clothing and tools allowances, all of which will complicate his accountancy. I do not know whether there would be much saving to the employer?—I would have thought so, Sir.

324. I suppose it is a thing you can only find out by trying.

325. Sir Harry Gill: As far as I understand your scheme, it is not based on the improvement of the present social services as such?—No, we are not seeking to alter the social services, we are seeking merely to leave them as they are.

326. I put that question because, as you are probably aware, we have a scheme from Lady Rhys Williams and from the Liberal Party, and my understanding of those schemes is that whilst going for simplification of the system they are largely based on an improvement of the social services, but yours is primarily concerned with a simplification of the income tax operation?—That is right.

327. And in support of that you have given us certain Tables. I take it they are merely figure tables?—Yes.

328. Would you agree that, assuming the principle of your alterations were accepted, then whatever the benefits were the contributions would have to be so arranged that the balance sheet would strike a balance?—Mr. Haynes: The contributions involving taxation is the broad sense?

329. Yes, I repeat it when I say your tables are figurative, the benefits are in one or two scales, whatever benefits were laid down then the taxation should be sufficient to balance those schemes of benefits?—We are trying to illustrate a piece of machinery and we do not feel it is our province to recommend in any way the levels of benefits or the rate of taxation.

330. And that they should balance whatever the cost?—The Budget should balance, it goes right back to the Budget I think because, as I have said before, we do not think we can link income tax in any way directly with allowances. We merely assume that the allowance should be a charge on the Exchequer, and the Exchequer will receive naturally the product of all forms of taxation.

331. But you have put up suggested rates of tax to meet certain schemes?—Merely looked at from the individual's point of view but not from the Exchequer's point of view. The rates of tax we have linked here with the various levels of allowances are merely to leave the individual's position as unchanged as possible, and not looking at it from the Exchequer's point of view.

332. Mr. Greenwood: I just wonder whether you do not possibly exaggerate the time which would be saved by the wage offices in industry because, as Mr. Carrington pointed out, there are very many individual adjustments to be made as it is, and they will still be there. There are such a large number, for instance, earnings in secondary employment, pensions, interest on savings, allowance for tax relief on pension contributions, life assurance premium, mortgage interest, single, married, children, dependants, married women in work. Those factors are taken care of in one code and it becomes rather simple really?—Looked at from that angle, perhaps, but when one sees the machinery at work between the Inland Revenue, and the individual and the employer week by week, month by month, it is amazing the number of communications, forms and calculations which are required.

333. But you are still left with most of these points?—Need one be? We deliberately of course have not gone into details, as we have said, because there is so much to them and there seemed to be no point in it unless the general principle were at least acceptable. Surely many of these details could be simplified or eliminated, could they not?

334. Chairman: But may not the practicability of the scheme depend on how far you can deal with the details? It is all very well saying you have settled a general principle first without regard to the details, but I should have thought there was a reaction between the details and the adoption of the scheme.

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[Continued]

335. *Miss Sutherland*: On this question of administrative savings, I take it that paragraph 39 of the Inland Revenue's memorandum really does not apply in this case because the extra administrative expense they refer to here is on the personal allowances, is it not, in the Liberal Party's scheme which do not really operate in this way? It is extra expenses for paying out all those 10s.

336. *Chairman*: Under your scheme there are personal allowances, are there not?—*Mr. Kirton*: There are personal allowances.

337. *Miss Sutherland*: They do not involve the payment out to each member of the public of 10s.—There are not personal allowances to single persons under Basis (A); there are under Basis (B).

338. *Mr. Anstey*: They are personal allowances to every member of the public, or only employees?—Every member of the public; not to a single person under Basis (A).

339. *Mr. Sutherland*: How would you expect to receive them except when it could be done through the employer? That was a topic raised yesterday with Lady Rhys Williams.—*Mr. Haynes*: In the same way as the present family allowances, either through the Post Office or the Ministry of National Insurance. Of course in that connection we have mentioned once or twice in our evidence that the weight of machinery for paying these family allowances would be very much simplified if they were equated for all beneficiaries. It is just a point in determining the amounts of family allowances for various types of beneficiary. If you eliminate the relationship question in determining the amount of benefit, it does simplify the work quite considerably.

340. *Sir Geoffrey Heyworth*: Just one point on the overlap of income tax on social security to which you refer in paragraph 19. I think you say here, and I think you said in answer to one of the questions, that you expected that in this way there would be a saving that would compensate some of the extra spendable income put in the hands of the lower income tax group—am I right in that?—*Mr. Kirton*: Yes, Sir.

341. And you give here an example of somebody earning £8 10s. 0d. a week, £7 15s. 0d. net spendable income, and then they are unemployed and you say under the present scheme their income only—"only" is the operative word—falls by £3 16s. 0d., leaving them £4 2s. 0d. As a married man with a wife and children his income falls to £4 2s. 0d. Can he adjust to that easily; would it not involve him going to public assistance or something else?—*Mr. Haynes*: It depends very much upon his own personal finances, does it not?

342. What I want to know is if you change the system in the way you say, are you assuming he is going to draw on savings or what?—It is very much easier for him to draw on savings for a week or two. One does hear of such cases. I do not think we want to emphasise this point, but I think there seems to be no doubt—the Commission will have other sources of evidence on the point—that this question of marginal reward does affect the output of work, and the margin in this particular case in relation to the wage is relatively small considering the difference between a week's work and a week's idleness.

343. Do you mean £3 16s. 0d. of £7 15s. 0d. is relatively small?—Looked at from another point of view it has been said that a 6d. level rate of tax is a strong disincentive. This could almost be regarded as equivalent to an 11s. or 11s. 6d. rate of tax.

344. How far are you relying on the apparent savings that might arise in this direction to counterbalance the additional payments that are proposed in other directions?—I think there would be some saving; we cannot quantify it though without more information. The real point I think is that this overlap, the payment of tax refund with the national insurance benefit, is so chancy as I said earlier on. If a man is off during May or June he probably will not get it, or only a very small refund because he has not accumulated his tax balance to draw on. If he is off in the early months of the calendar year, that is towards the end of the fiscal year, he has probably his tax to draw on and he can get that refund for a number of weeks according to his tax category. But there is no deliberate social policy lying behind this; there could not be when it is seasonal and you can get it at one period of the year and not at another. If

the amount that is paid during sickness or unemployment is not in itself sufficient and has to be supplemented, that is a question of social security, it is not really a question whether the tax machine ought to come in and just make a refund to even it up in certain cases.

345. I am not quite sure whether the real point is that you want to remove an anomaly because you think it is not just or whether you think this is a necessary part of the whole scheme of providing a saving in one bracket so to speak to compensate for extra payments in the other?—Firstly it would disappear automatically under this scheme; secondly, as Mr. Kirton has said it would improve incentive by reason of its disappearance, and thirdly I think on the grounds that it is so chancy and that the refund applies to only one part of the fiscal year we would say it is more equitable that the system of refunds should not be retained.

346. Under your scheme is public assistance to continue?—We have not dealt with that. *Mr. Kirton*: Yes.

347. You would admit there might be a repercussion in changing to your system in the amount of public assistance that was payable?—*Mr. Haynes*: Yes, it would be interesting to know whether there is more claimed by way of public assistance in the early months of the fiscal year when there are no refunds than later in the year when there are. *Mr. Kirton*: If you introduce public assistance, I cannot help but feel that under the present basis of taxation a man earning £3 a week with four children may be a bigger drain on public assistance than he would be under ours. There is that reverse effect if we bring in public assistance.

348. *Mr. Carrington*: There is one point I would like to put to you arising out of a previous answer. Do I gather that your additional tax, or I think you use the term "superstructure", would be assessed and collected in arrears?—*Mr. Haynes*: It could be.

349. Do you visualise it being?—I think we said that a Pay as You Earn system could easily be devised for it and the numbers are relatively small, only a fraction of those at present affected by Pay as You Earn. But our suggestion is that it might be advisable to put it on a past year basis, mainly for incentive reasons.

350. If you put it on a past year basis, does it not involve giving everybody who comes within it a tax holiday in order to get on to the past year basis?—I do not think so, surely. You mean the reverse of forgiveness?

351. A tax holiday—I do not think so. It is surely a matter of tax for the year, assessed in a different manner next year from the way it was assessed last year.

352. Supposing you make the change at 5th April, 1952; if you are going to charge in arrears is your taxpayer going to pay anything during the fiscal year 1952-53?—On last year's income.

353. He has already paid on last year's income.—As a matter of assessment yes, but surely under the old tax system there were many cases when a man was assessed in two successive years arithmetically on the same income?

354. But it is not only arithmetical, it is factual. Under P.A.Y.E. you get collection on actual income and then subsequent assessment is on that actual figure; so your taxpayer surely would have paid tax already on and for the year ending 5th April, 1952.—As I say, under the old tax system before P.A.Y.E. if you entered upon a new employment were you not taxed in your first year on the current year basis and in the second year on the past year basis? Therefore the same thing could have been said then, but it was treated I think purely as a matter of convenience and arithmetic but the tax applied to two separate years. I think there was a right of appeal in cases where the income varied.

355. Would you agree that no tax would be collected in 1952-53, or would you say—"I will collect in 1952-53 on the income of 1951-52"?—The latter. *Mr. Kirton*: You could not have an actual loss of tax on one year any more than when P.A.Y.E. was brought in you could have collected two years' tax on one year, it is just the reverse of the forgiveness problem.

356. *Chairman*: The change to P.A.Y.E. did I think involve letting people off seven months tax, and *Mr. Carrington* is suggesting the same thing might have to happen again.—*Mr. Haynes*: In reverse.

357. *Sir Geoffrey Heyworth*: But you get the benefit,

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[Continued]

358. Mr. Keldor: Instead of not paying tax on one year's income you pay it twice.

359. Mr. Carrington: I suggest you get this position; either a man pays tax twice on one year's income or you have got to give a tax holiday.

360. Mrs. Anley: On the basis of one year's income, which is a different thing from paying on one year's income.—Mr. Kirton: You pay twice on one year's income.

361. Mr. Carrington: I want to follow this up. If that be the case, what is the situation when a man dies under your scheme; does he die owing a year's tax, or does he not?—Mr. Haynes: You mean under the supplementary tax structure?

362. Yes.—I do not know, I think it is a matter to be decided.

363. It is a very important point because it was a great difficulty in the old Schedule B, because there were a lot of arrears to be written off—I would say he would not die owing arrears. There might possibly be imported into the system the right to the Inland Revenue to revise the final year's tax on a current year's basis if they wished to, but this surely has all applied in the old days under the old Schedule B, has it not? In other words, the past year basis is well established.

364. That was one of the snags of the old Schedule B basis, that whenever a man retired or died he was owing a considerable sum in tax. One of the supposed benefits of P.A.Y.E. is that when a man retires or dies he is not owing any income tax; he owes surtax but not income tax. On your superstructure what is the position at the cessation of employment, death or retirement, is he owing tax or is he not?—I would say offhand that he is owing tax up to the date of death or retirement.

365. For what period?—In other words for 1952-53, if he dies on 5th April, 1953, to take an easy case, then he would be due tax up to 5th April, 1953, tax for the fiscal

year 1952-53 computed on his 1951-52 surplus income unless the Inland Revenue retain the right to revise that final year's assessment on to a current year basis.

366. Mr. Millard Tucker: Let us put that right. If he died on 5th April, 1953, that is in the fiscal year 1952-53, he would not be owing any tax for 1951-52, would he, because he would have paid it on 1st January, 1953?—But he would . . .

367. He would be owing tax for 1952-53 is full for the whole year?—Yes.

368. You put a wrong date in just now.—I am sorry, that is what I meant.

369. That is the right answer, is it not, there is one year's tax still owing, superstructure tax, at the date of retirement or death if he dies or retires at the end of the year, and if he dies or retires in the middle of the year there is that fraction of the whole year still owing?—Yes.

370. Chairman: I gather you were saying he would die owing the tax for 1952-53, but that would be calculated on the basis of the income for 1951-52—that is what I thought you were saying, I do not know whether you meant it?—Mr. Kirton: Is it necessary that the legislation should be so drafted? It is surely a matter of legal drafting as to whether on the cessation of employment or death, payments up to date have to discharge all liability, or whether there is a year or a fraction of a year outstanding, is it not?

371. Mr. Millard Tucker: You could not have a superstructure computed on the previous year's income and the ordinary structure based on the actual year's income. What you said, as I understand it, is that this is not altering the basis of computation, you would always assess on the income of the actual year but, in the case of the superstructure tax, there is a delay in payment, is that right?—Yes.

Chairman: Thank you very much; we are much obliged to you both for your memorandum and for coming here this morning to give evidence.

The witnesses withdrew.

SIR ARTHUR CONYNE CARR, K.C., MR. GUY NAYLOR, MRS. GUY NAYLOR, MR. ALAN PEACOCK, D.S.C., M.C., and MISS NANCY SEAR, on behalf of the Liberal Party; called and examined

The Liberal Party submitted as a memorandum a Liberal Party Yellow Book entitled, "Reform of Income Tax and Social Security Payments".

This book was published in March, 1950, price 1s., by The Liberal Publication Department, 8, Geyfere Street, London, S.W.1; and the Scottish Liberal Party, 26, Frederick Street, Edinburgh.

EXAMINATION OF WITNESSES

372. Chairman: Sir Arthur, you and your colleagues are here collectively, I understand, to represent the Liberal Party on this question?—Sir A. Conynne Carr: Yes.

373. If I address my questions to you, I shall leave it to you to decide who should answer them; if you do not want to answer a question yourself I shall quite understand if you say you will call on some of the other members of your delegation to answer it, but I should not propose to expect an answer from each person to each question.—No, certainly not. It was my intention to make a preliminary statement with regard to the Inland Revenue Memorandum.*

374. That was the next question I was going to ask you. Would you like to make a preliminary statement about it? If you do, you may avoid most of my questions because most of them are based upon that document.—If I may do that with regard to the body of the memorandum and then ask Mr. Peacock to make a few remarks about the financial details at the end of that and then, if there is anything I have omitted which any other of my colleagues wish to add, I would ask permission for that to be done.

375. Certainly.—May I begin by introducing my colleagues to the Commission; the Chairman of our Committee, Mr. Guy Naylor and Mrs. Naylor who acted as secretary of the Committee, Miss Sear, Mr. Alan Peacock.

* Memorandum submitted by the Board of Inland Revenue is reproduced on pages 59 to 66 (Third Day).

We are gratified and at the same time rather surprised that the Board of Inland Revenue have thought it necessary to deliver this heavy broadside, which I must say appears to us to be of a slightly partisan character, against our proposals, but at the same time it is very convenient because it gives us the opportunity of meeting right away the objections which they make and I would like to go through the body of the memorandum, making certain criticisms and a few general remarks about the figures, before I call upon Mr. Peacock to speak on them in detail.

I propose to pass over Part I which is merely briefly descriptive of the various schemes and go to Part II which is headed "General Examination of the Principles underlying the various Schemes". I would like to go to paragraph 22 where they state what they believe to be the objectives of the various schemes, because I think they have got them wrong:—

"(1) To amalgamate income tax and social security into a single coherent and logical system."

Now, there are two sides to that, one of which is the amalgamation of the collection of contributions for social security with income tax and that has always been and remains an objective of all of these schemes, I think it certainly is of ours and it is one which we claim completely to have fulfilled.

With regard to the question of the benefits under social security it is quite true that in her first proposals Lady Rhys Williams put the weekly payments so high that in

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[Continued]

her view they covered the whole of the insurance payments as well, but neither in subsequent versions of her scheme nor in any of the other schemes including ours has it been an objective to amalgamate completely the benefits under other parts of the social insurance scheme with the allowances under the income tax scheme. Therefore when repeatedly throughout this document the Board suggest that the scheme has broken down because it fails in that original objective I should like to say at once it never was an objective so far as we are concerned.

Then they say:—

"(2) To remove the disincentive effects of the present income tax by substituting a flat rate."

Of course, we have never suggested that any tax can be other than to a certain extent disincentive and the word "remove" should be "reduce".

Then the third objective:—

"(3) To simplify administration."

That is quite correctly stated. But in that very paragraph, a little lower down, they say:—

"By bringing back the National Insurance benefits scheme, as modified, now failed to achieve the primary objective of amalgamating the two systems."

And they keep on saying that, but that is a misapprehension.

Then there is a sentence at the end of that same subparagraph where they are talking about the attitude of the worker towards taxes and allowances from taxes and so on and they say:—

"What the worker is concerned about is the net pay he finds in his pay packet; he is not likely to concern himself unduly with the arithmetical processes underlying this result."

Now, I am really astonished at that statement. I should have thought by this time the Board of Inland Revenue had discovered that a very large proportion of the working people of this country are diligently engaged in studying the details of P.A.Y.E. These things are studied in the most minute detail and that is one of the points I will deal with again when we come to the question of disincentives, but it is, in my submission, a complete fallacy to suggest that the details of the way in which the pay packet calculation is made are not closely studied by a considerable section at all events of the working people of this country.

At the moment I am not going into the final subparagraph of paragraph 23 where they refer to the Liberal Party scheme because I am coming on to the points there made in detail later on, but when I come to paragraph 24 headed "Administration" I think I ought to challenge that paragraph at once, although it may be necessary to revert to the question again when they themselves do so. In that paragraph they say:—

"The third main objective these schemes set out to achieve was a saving in administration. This expectation was based on the assumption that with the amalgamation of income tax and social security the existing 'duplication' would be swept away and a single Department would replace the Inland Revenue and the Ministry of National Insurance. Once it is admitted that supplementary social security payments would be necessary the major economy anticipated disappears. Even with a modified scheme of the kind the Liberal Party propose, there would on balance be more not less work than at present in the Civil Service."

I challenge the whole of that statement in every part. I submit that it is completely false and completely inaccurate from start to finish.

Let us just examine it. What is the work which the Ministry of National Insurance has to do at the present time which would be done away with by this scheme? In the first place, there is the printing and distribution of the cards and the stamps. These would both disappear. It might be necessary, for unemployment insurance purposes, that the worker should have some kind of document which he could deposit at the employment exchange when he was out of work, but apart from that no cards and no stamps would be necessary in any way. That means that the very considerable department which now exists, I

believe, in the City of Newcastle for the sole purpose of counting and checking these cards and entering up the number of stamps which each individual worker has to his credit would cease to function.

The second aspect of the matter, which is an even more important saving perhaps, is that it would no longer be necessary for the great labour to be incurred, when a claim is made for benefit, in checking up whether the worker has the appropriate number of stamps on his card to qualify him for the particular benefit which he is claiming. That is such an immense labour that I have reason to believe that during the influenza epidemic of this Spring, it nearly broke down altogether. The whole of that would go.

The only part of the National Insurance administrative machinery which would have to be retained would be that which is concerned with the distribution of supplementary benefits, the payment out on medical certificates. In so far as they do maintain today any of the very beneficial system which the old approved societies used of health visitors visiting the patients in their homes, no doubt it would be desirable that that should be retained also, both from the point of view of the good the health visitors do and also from the point of view of checking up on the gentleness of the continuance of the sickness. That part and that part only of the existing machinery of the administration of National Insurance would no doubt have to be retained, but the whole of it which employs the very large clerical staff they now have would go.

When it comes to the revenue side, I notice with interest that the Board themselves admit later on that it would enable them to dispense with from 10,000 to 15,000 employees of the Board. I should have thought that was an under-estimate, but it is interesting to observe that they make that admission.

Reverting for a moment to the National Insurance administration, I would like to say, as I see was suggested by Lady Rhys Williams in her memorandum, that it would make it very much easier to deal with the question of supplementary benefits, which are now paid through the machinery of the National Assistance Board, through the same machinery as that of the Ministry of National Insurance. This would again mean a very considerable saving in administration and also probably produce more satisfactory results because the whole matter could be considered and dealt with at one and the same visit instead of two.

I come now to paragraph 25 in which the Board quote Lord Beveridge against us on the question of doing away with the separate insurance contribution. They quote him against us possibly because they are aware of the fact that he is an honoured and distinguished leader of our party, but we do not for that reason have to agree with him about everything and on this particular aspect of the matter we venture to think that experience has shown that the separate poll tax, that is to say the flat rate insurance contribution, is something which no longer represents the real truth of the cost of insurance and, if it leads the worker to believe he is paying for it all himself by that single contribution, then it is grossly misleading him. If, on the other hand, it conceals from him the fact that he is paying most of the rest of it in the form of other taxation, it is also grossly misleading. By our system of rising the contribution in the form of income tax he would see, and it could be made clear to him on whatever document was supplied to him justifying the deduction from his wages, exactly how much of what he was paying represented his total contribution to the social welfare schemes as a whole instead of, as now, showing him only a part of what he pays and, as I say, misleading him into supposing he does not pay any more. Of course he does. He pays practically the whole of it in one form or another. Certainly he pays the whole of what is called his own contribution and the greater part of what is called the State contribution. The employers' contribution is a separate matter which I will come to in a moment.

Just to illustrate the proposition, I may point out that contributions amount to £190 million out of a total of £600 million, but even that is misleading because that only covers part of the cost of the health services. The rest of the health service is paid for outside that. On the other

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hand, it is also misleading because the £150 million which he pays and what his employer pays is mired in a very heavy sum which goes into a surplus which is treated in the budgetary statement as part of the Investment Fund, but it is on any experience we have had for a number of years past, ever since the scheme was introduced, entirely excessive and unnecessary because it is based upon an assumption which on the pre-war facts was no doubt well justified but has turned out to be quite unjustified on the post-war facts, of 8½ per cent. unemployment. It has not happened.

Then in sub-paragraph (iii), which is in part of the passage quoted from Lord Beveridge's Report, he says:—

"(iii) To require contribution on an insurance document for each individual has administrative convenience, particularly for a scheme which, while it covers all citizens, takes account of their different ways of livelihood, and classifies them, giving different benefits according to their needs."

Now, that is just our point which we want to emphasise. It is right that the benefit should be distributed according to the needs of the recipient but, in our view, it is wrong that they should be raised in whole or in part by a poll tax which takes no regard of their ability to contribute to those requirements.

As to administrative convenience, as I have already pointed out it involves a very large administrative expense which was necessary in the days when you had the separate approved societies but which in our view is unnecessary now that it is amalgamated into one national scheme. I think perhaps I might just add that the excess contribution, when you had separate approved societies, went to the benefit of the members because the approved societies were permitted to declare an additional benefit when they had a surplus on valuation. Nobody is valuing this surplus of I forget how many millions of pounds which is in the Insurance Fund at the present time and the contributors do not get a penny out of it.

Then in paragraph 26 they say:—

"The objection on income tax grounds to the other two is simply . . ."
that is, the Liberal Party's scheme.

376. No, it is not, that is just what it is not, because it says:

"The last of these is considered in detail in Part III of this article."

—Yes, I beg your pardon. I am sorry, I misread that. I do not know why because, if the objection is valid it should apply equally to ours, in fact. What they say is this:—

"The worker queues up at one pay-window to get his pay less 3s. or 5s. in the £ and he then queues up at the second window to get the value of his allowances refunded. He is thus left substantially in the same position as he is at present and he is not likely to be deceived by the fact that it has taken him two steps to get there instead of one."

That, in my submission, is entirely fallacious. To begin with, there is no reason in the world and we suggest as one alternative, an alternative which I personally favour, that there is no necessity under our scheme at all events for the worker to draw his allowances separately from his pay. It would simplify the administration very much if the amount of the allowances was simply deducted from the tax in making up his pay packet. That is a point I will deal with in a little more detail when we come to a later paragraph where they state this objection in more detail, but actually at the present time the man has to do just the same thing; he has to queue up at one place to get his pay packet and he has to queue up at another place or somebody has to queue up on his behalf at another place to get his family allowances and at a third place to get his sickness or unemployment benefit if he wants it. This payment merely takes the place of the family allowance in the scheme of things and it makes no difference in the amount of queuing he has to do, particularly if, as I suggest, the alternative of deducting the allowances from his tax when his pay packet is made up were adopted.

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May I now comment on paragraph 28 on which I want to say quite a bit? It is headed "The Effect of the Proposals on the Wage Structure" and it says:—

"It is often argued that the income tax tends to be reflected in the wage level so that ultimately it is passed on to the consumer at least in part in the form of higher labour costs and higher prices. The answer usually given to this argument is that the amount of income tax payable varies from one worker to another according to his personal circumstances, etc., and that there is thus no common figure which could be taken into account in wage negotiations. If, however, everyone were subject to a common rate of tax, so that every £ earned were worth, for example, only 15s., it is a matter for serious consideration whether this might not lead to claims for higher wages."

I want to make two observations about that, firstly to enter a caveat and to say we must not be assumed to be of that very large class of the public which has adopted the fashionable dogmas in favour of the Wage Freeze or the Wage Semi-Freeze. That is a matter which we are considering at the present time and I merely desire to say today that we express no opinion about it one way or the other. There is a great deal to be said in criticism of the grounds on which it is commonly supported—I won't say more than that, but as far as the effect of this scheme is concerned on the wage structure, in our view, it is one of the most important points. If you look at the tables, and it does not matter whether you look at our tables or the revised tables which the Inland Revenue want to submit, the striking thing about them . . .

377. Are you referring to the tables in Schedule 2 of your book?—Yes. The striking thing about them is the very great benefit which the scheme gives to the low-paid worker with a family. On our calculation the low-paid worker, single, pays a little more, but the low-paid worker with a wife gets £14 more and the low-paid worker with a wife and two children gets £53 more and the low-paid worker with a wife and three children gets £65 more.

First of all, let me make it plain why it works in that way, because it is rather important to realise that, it is not just a present to the low-paid worker. It is giving him something which other people get today and which he does not get in this way. There are at present two kinds of family allowances; the 5s. a week which is paid to everybody in cash, omitting the first child, and the income tax deduction for children which curiously enough works the other way about and may be higher for the first child, I think I am right in saying, than for the subsequent children and is much larger in amount, much larger. Well now, in the case of the low-paid worker with a family, he does not get that income tax allowance for his children at all. All he is told is, "You are happy in not having to pay income tax", but his income tax is wiped out by his other allowances before he gets to the family allowance; when you get to a little higher wage level he gets part of it and the rest is wiped out, so that he is not getting the family allowance which the richer man is getting. You may justify that or not. We think it cannot be justified, but anyway it is the fact that we are correcting what we believe to be an anomaly which results in these very big advantages to the family man in the lower wage groups. When you come to consider the effect of that upon the wage structure, you will notice that in most of the wage movements which have broken through the Wage Freeze in the last few years, emphasis has been put, and no doubt rightly put, on the grievance of the low-paid worker and it is his wages which have been increased to the exclusion altogether sometimes or in almost all cases of the skilled man earning more, but actually the low-paid worker with the grievance is the one with a family. What it has been attempted to do by these wage settlements is to meet his very big grievance by a very small concession because a concession is so far as it is made on wages has to be made to everybody who earns those wages and you just could not possibly consider, or at least nobody is willing to consider, increasing the wage of the low-paid worker who is a bachelor to an extent which would really meet the grievance of the low-paid worker with a family. This scheme does away with that altogether and it removes the claim of

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the low-paid wage earner to special consideration as distinct from his fellows, the more skilled men, in wage negotiations.

That preference in favour of the low-paid wage earner in these wage negotiations has in its turn produced another grievance which is also constantly causing trouble in industry, i.e., that it is in process of wiping out the differential between the skilled man and the unskilled man so that the skilled man says, "What is the good of my having gone through an apprenticeship and acquired a skill if I am going to be paid very little more than the other fellow who has not?" If I may put in a word for a still more oppressed class of the community, we are always calling out for an increased number of technologists in industry, but what is the good of asking people to take university degrees in science and engineering and then paying that man less than a skilled craftsman when he has done it? The whole structure of wages and salaries has been put out of gear largely because of this perfectly legitimate grievance of the low-paid family wage earner which cannot be met in that way at all, but is completely met by this scheme of ours. That is what I want to say about the wage structure.

I come now to paragraph 30 which deals with finance and I want to read to you the first sentence of the second sub-paragraph:—

"Nor is it possible to say that the rates of tax and benefit proposed are merely illustrative and can be altered up or down to make the scheme solvent."

They are pointing out that in their view our scheme . . .

378. I think it is not directed so much to your scheme as to the Haynes and Kirtom scheme which expressly stated that they were not endeavouring to deal with cases and they said in their evidence this morning that that was not the kind of thing the Inland Revenue people ought to be able to do for them.—We have also said something of that kind, but I wanted to make clear what we meant by it and that was why I referred to this paragraph. We have said that we are not wedded to the particular combination of 5s. and 12s. 6d. for the following reason. It would be a very laborious process for which our resources are inadequate to work out in relation to all the various people all the way down the scale the effect of a particular combination of figures and the most we could do was to work out a few sample cases and then select the one we thought the best. If the Commission were in favour of the principle of the scheme at all, I should hope that some more sample variations would be worked out because it might well be that a better combination than 5s. and 12s. 6d. would be found or 5s. and 10s., according to whether you take the extra 2s. 6d. for food subsidies or not, and which would produce the results we are aiming at more accurately all the way down the line. We are not, however, saying that you could ignore figures relating to the solvency of the scheme and I am going to deal with these in due course, but we do say that, although this was the best combination we could find in the time and with the resources at our disposal, it is quite possible a more satisfactory one, either up or down, could be devised which would more accurately produce the results. On that I want to make just one further point, that when you draw up a table like this comparing the results under the scheme with the present results, it is inevitable that not in every case will the figures produce the result we are aiming at, namely, to improve the position of the family man all along the line, even to a small extent at the expense of those without dependents, because, however equitable our scheme may be, the existing system produces a very anomalous graph. The result is that when you compare any new scheme with it, at some points it will appear to make A better off and at other points, for no particular reason that one is aiming at, it will appear to make B less well off, but that may be because B is too well off now under the existing system in comparison with A.

Now I come to Part III in which they deal with our Scheme, and in paragraph 31 they set out five sub-paragraphs. It is perfectly correct to say that our 12s. 6d. includes 2s. 6d. which is financed by a reduction in the food subsidies. That is, of course, a separate point and we quite agree that is a separate point. We think it is right in principle, but it is not, from the point of view of

the income tax scheme as such, an essential feature of it. You could perfectly well, if you did not agree with our view about the food subsidies or if you thought those were outside your terms of reference . . .

379. I think they are. If that was your view you could consider our scheme for your purposes as being a scheme for 10s., retaining the food subsidies. The principles I do not propose to argue about one way or the other.

Sub-paragraphs (ii), (iii) and (iv) depend entirely upon their criticisms of our finance, and therefore I do not propose to discuss them now. I will come back to that later on. With regard to sub-paragraph (v), I think I had better wait until I come to the detail of that.

Then in paragraph 32 they say, and I want to point out that this is only a partially correct statement:—

"Moreover, to avoid penalising the income tax payer with a family they also reintroduce an income tax child allowance."

That is, of course, only in relation to what we have called the supplementary tax on incomes over £600 a year and that is an alternative to increasing the child allowance in respect of those higher incomes. I noticed that Lady Rhys Williams proposed to introduce a higher child child allowance in proportion to income. This is, as far as it goes, doing the same thing and it does not matter for the purposes of our scheme which way round you do it.

I would like to point out that in paragraph 33, where they quote from our report, in sub-paragraph (i) the words:—

"The basic weekly payments" augment considerably the lowest incomes."

We should have said there "the lowest family incomes". It is quite true that our scheme differs from Lady Rhys Williams' in that whereas she proposes a scheme which would increase the lowest income even for the bachelor, our scheme charges the bachelor a small amount even at the lowest rate. In the last part of that paragraph, with regard to the rates of benefit for the old, the unemployed, the sick, etc., they say:—

"All we would say is that we understand that if the changes were thought desirable they could be made within the framework of the existing insurance schemes."

It is quite true that the rates could be varied within the framework of the existing insurance schemes; but the whole of the advantages of simplifying the insurance schemes could not possibly be obtained within their present ambit.

In paragraph 34 they again return to the attack when they say that our claim that it "augments considerably the lowest income" is hardly borne out by the facts. I have made my point on that, that it should have been "family incomes".

In the last part of that paragraph, they say:—

"It could be claimed, with rather more justification, that the basic weekly benefit favours the family as opposed to single and childless couples. But as the figures in the Appendix show the benefits are unevenly distributed and their incidence would be difficult to defend."

That is purely due to what I have already pointed out, namely that when you start comparing a new system with an existing system which is already anomalous the differences will not be uniform all the way through, but there will be, necessarily, differences at different points. It is purely a question of which is the sounder system.

Paragraph 35 contains a really astonishing series of fallacies. There they say:—

"But in making this comparison, the Liberal Party have overlooked the fact that most people with incomes below £600 a year have no liability to tax at the standard rate at all. There are 19 million people with earned incomes below £600 a year but above the income tax exemption limit of £135. Of these 6 million pay nothing at all, 4 million pay only 2s. (2s. 6d. less one-fifth earned income relief), 84 million pay only at 4s. (5s. less one-fifth earned income relief) and 1 million

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pay at 7s. 2d. (9s. less one-fifth earned income relief). Of the 19 million, therefore, 18½ million would pay a higher rate under the Liberal Party Scheme than they do at present and only ½ million would pay at a lower rate."

Well! well! They have entirely forgotten that everybody under the existing system pays £12 15s. 8d. for National Insurance contributions which are included in our income tax, so that the whole of that criticism goes by the board by reason of that simple fallacy.

380. I do not know if you have worked out how much that represents in the £?—You cannot say how much it represents in the £ without considering a particular income.

381. Therefore, unless you can do that you cannot be sure whether the effect of including it would be what you think or how far it falsifies the last statement that 18½ million people would pay at a higher rate?—It falsifies it completely because in our tables we have included it and it is worked into our tables. It is shown under the heading "Net Annual Income" which is the last column but one in our table.

382. You have allowed for the £12 15s. 8d.?—Yes. The deduction from the gross income in the first column includes the national insurance contribution. That is how the comparison is made between our deductions which are for tax only and the existing deductions which are for tax and insurance contributions. The 4s. 11d. refers to the employed worker, the self-employed person pays 6s. 2d. so that in their case it is even more so.

Then there is another major error in the last sentence of this paragraph. They say:—

"Moreover, the flat rate tax under the Liberal Party Scheme falls on every penny of the income earned while the existing rates fall only on the excess over a given tax free amount. This point is of particular importance where the decision is whether to work or not work at all, e.g., in the case of the married woman or the pensioner. There is no doubt that in these cases the Liberal Party Scheme would be a considerable deterrent."

Well! I am surprised. That remark has some truth as applied to the married woman because she can earn what she likes at present and her earnings may or may not be taxed, but they certainly would be taxed under our scheme and if it did so as some deterrent to married women going into industry there are some of us, at least, at this table who think that would not be a bad thing, but, as far as the pensioner is concerned, it completely overlooks our proposals. If you will turn to paragraphs 80-90 of our booklet, in paragraph 80 we say:—

"(A) OLD AGE PENSIONS. We propose that old age pensions should be increased to 28s. 6d. a week and that furthermore the same pension should be paid to wives of pensionable age as to their husbands. In order to encourage the old to remain at work we recommend that all pensions should be payable irrespective of income from other sources, whether earned or unearned."

At the present time, as you probably know, if an old age pensioner earns £1 a week he loses his pension altogether. In paragraph 90 we deal with a minor anomaly about the old age pensioner with a small income and we say:—

"If the income is unearned the pensioner receives it and receives his pension as well; if on the other hand he obtains the same income by working his pension is withheld from him."

That is the state of affairs at the present time. I think £1 a week is the limit he is allowed to earn and if he earns any more than that he loses his pension altogether. We say that should be done away with in toto and that he should be allowed to earn what he likes without losing his pension. We believe that it is going to be of vital importance to offer an inducement to old age pensioners to continue working, especially in the years to come when the proportion of old people in the population is going to rise very rapidly, all of which was fully considered in the Royal Commission's Report and particularly in the Report of the Economic Committee of the Royal Commission on Population. There are some of us who do not give up working when we are 65, perhaps we

cannot, but at all events we do not. We believe that a corollary of the rising span of life is a rising span of good health; that is to say, not only do people die at a later age on the average now but they retain their working capacity to a later age on the average than they used to do and we have given what we consider the strongest possible inducement to old age pensioners to continue working, so that this statement is not only not the truth but it is the precise opposite of the truth as applied to our proposals.

While I am on that point, and in order to avoid coming back to it again when I come to the financial criticisms, I propose to point out that the Board of Inland Revenue have been very careful to pick up every case in which they think, rightly or wrongly, we have over-estimated in favour of our scheme and they do not pick up a single case in which we have under-estimated. For example, because we had no figures upon which to estimate we have not mentioned at all in our pamphlet the tax which would be obtained on the additional earnings of old age pensioners. There were in 1948 4.6 million old age pensioners and we provide for their pensions, but if only half of them earned only £2 a week more than they do now when they are not allowed to work, that would mean additional income tax of possibly £80 million assuming a rate of 5s. in the £. You cannot quantify it. You do not know how many of them would work. No doubt quite a number of them would go on earning full wages.

Then in paragraph 36 we come to the question of disincentive and I should like to say a little bit about that. I would like to say first of all that it is, if I may say so, a fair hit for them to quote against us the criticism we made of Lady Rhys Williams's scheme on that point; but to say, as they do, that it applies with equal validity to the Liberal Party's own scheme is, of course, not true because the point is simply a question of amount. Her scheme as it was at the time when we were criticising it was based on 6s. 8d. ours is 5s., but I will say quite frankly that I think we overstated considerably the point we made in the paragraph they have quoted. Having said that, let me come to this question of disincentive, disincentive is general. In a sense it is, of course, true that all taxes are disincentive, but in a sense it is equally true that all taxes are incentive, but what is quite plainly true in my submission is that the disincentive effect is much higher in a graduated tax and the incentive effect which offsets the disincentive effect is much stronger in a flat rate tax.

Let me explain what I mean by the possible incentive effect of taxation. I think it is true to say that the majority of people in every walk of life have a standard of what they want to have net in their pockets and the people who are prepared to make a great effort to get more are the minority. The standard varies and when you get to a point in the higher income groups of course it becomes very acute. When you get to the point of saying "Well, I can earn so much, which is all I really need, and if I work myself to death I will only get—I won't say 6d. in the £ because I will not fly as high as that in my imagination—but perhaps 2s. or 3s. in the £ left out of what I am going to earn by all this extra effort which is ruining my health", you do not do it, or a great many people do not do it and the same thing is equally true in a different way in the lower income groups. I venture to say that one of the principal causes of absenteeism, for instance, in the coal mines, is the fact that if you live in a mining village, in a cottage which is not a very good cottage, and you cannot put any more furniture into it than you have got already and even if you drink beer, you do not think much of the beer you can get today, and you cannot smoke more than you do smoke and you can only lose a certain amount on the dogs, what is the good of earning more than your average standard you have got used to? That is I think the attitude of mind of a great many people and that simply not having any particular use for more money than a certain amount is the reason why a lot of people do not put in full time at work. If a man says "I want to have 66 or 68 net" and it is taxed, then he will earn a little more; he will work a little more until he has got his 66 or 68 net, whatever his particular standard may be. In that sense, although from one point of view it is true to say that any tax deters a man from working, from

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another point of view it is true to say it makes him work because he wants to get up to whatever figure of income he has in mind as being satisfactory to his standards. They may be fixed standards or they may be changing standards, but he will work to get up to his standards. So, in our view, this talk about the disincentive effect of taxation is a thing that cuts both ways and on balance there is precious little in it, but I do most strongly believe that if we are comparing two different kinds of taxation, the disincentive effect of a graduated tax which is substantially higher on the last £ than on the first is infinitely greater than the disincentive effect of a tax which is at the same rate, whatever it may be, on every £. It is the point that you cannot dodge it whereas the other you can, so I do submit that our point is perfectly valid and that our scheme, by providing a flat rate and avoiding the jump, is much more important than in paragraph 37 of their memorandum the Board will admit it to be, although they admit there is something in it.

Now in paragraph 39 they come back to the question of administration. I have dealt with that to a certain extent already, from the point of view of the national insurance scheme, and I do not think I want to add anything about its effect on national insurance, but I do want to add something about its effect on industry, they admit themselves that it would involve a substantial saving in the Inland Revenue staff itself. I want to add something about—and I gather you have heard about this this morning from the witnesses who were here—the cost of the administration of P.A.Y.E. in industry.

383. They expressed complete inability to quantify it in any way whatsoever. You cannot quantify it for industry as a whole, but there is no question about it, I happen to be a little bit concerned with industry as well as with law, that the complications of P.A.Y.E. as distinct from the stamping of insurance cards and all the rest of it and as distinct from the extremely simple wage calculation we are advocating, adds enormously to the administrative cost of every industrial business. In small businesses such as I am concerned with it does not so much mean extra staff; it means partly that we have to employ an extra person but chiefly it means that our Secretary is too busy to prepare the financial statements we ought to have; that is to say, it means either extra staff or overwork and inefficiency of work in other directions and it is really a serious matter in our view, to which we would urge the Commission to pay very considerable attention.

In the same paragraph the Board of Inland Revenue deal with this question of what they allege to be the increased cost of distributing or paying out on the coupons or whatever you call them for the allowances.

384. That is, the 27 million?—Yes. In my submission, there is a very great fallacy in that argument. In the first place, as I have said, their figure of 27 million ignores entirely the fact that for 19 million of them, namely those employed, you do not have to pay it at all, if you do not want to do so; you can simply have it deducted from the pay packet; that is to say, the calculation of the pay packet would be—gross wages so much, tax so much, namely 25 per cent. less 12s. 6d. or whatever the figure is, and pay the net difference. Whether it would be necessary for the man to surrender a coupon to the employer is an administrative point and it would not involve any considerable expense anyway. It might be necessary, for this reason, that if he became unemployed he would want his coupon and it would be a pity to have to go and get a fresh one. Whether administratively it would be more convenient to give him a book and let him surrender it week by week to his employer except when he was unemployed or whether it would be better to let him get one specially when he was unemployed is a point of minor administrative convenience, but the 27 million just disappears and you get down to this, that there would be 8 million—I do not quite know where they get that figure of 27 million from, but there would be, whatever the figure might be, of wives and children's coupons which the wife would normally cash on behalf of herself and the children. Well, she does it now for all the children except the first; she has to go and cash her family allowance coupon, and it would merely mean that when she went to the post office to get it she would get much more; she would collect her own and one for the first child as well as one for the second child. That is

all it means. It does not mean a single additional visit by anybody to the post office beyond what is made now, it merely means that when the lady got there, there would be a little bit more business to transact and a little more money to pay her than at the present time. The only case in which it means an additional visit to the post office, I should have said, was the case of the wife without a child and the wife with one child. She does not go at all now because she has nothing to come. She would have to go. Those are the only additional cases who would have to go to the post office to collect the coupons at all, if those for the actually employed persons were paid through the employer. On any submission it is quite ridiculous, in view of what I have said, to make the statement made by the Board of Inland Revenue at the end of paragraph 39 where they say:—

"On balance, therefore, it would seem safe to say that overall the scheme would mean more rather than less work in the Civil Service."

We now come to paragraph 40 which is headed "Technical Difficulties" where they say:—

"We have so far confined our observations to the main points of principle to which the scheme gives rise and we believe that it is primarily by reference to these that the scheme must be judged. Nevertheless we think the Commission should be aware that the scheme does give rise to a number of important practical difficulties; for example, the assessment of married couples where both are earning."

No such assessment is required by us. Each will pay on his or her own earnings and it is certainly no part of our scheme that we should lump them together, as would happen now, and charge them the higher rate. They are all on the same rate anyway. Whether if jointly they went over the £500 a year they should be liable to our supplementary tax jointly is another matter, but we are opposed in principle to that. It is only in that event that, even if the present system of aggregation of spouse's incomes were retained, there would be anything to do at all, and as far as earnings were concerned, they would have to make no assessments.

The next thing the Board say is this:—

"Collection of tax in respect of subsidiary income." Well, they would have to do that. They have to now if they can and they would have to in future if they can. There is no difference or no change. Then they say:—

"Deduction at the source from dividends and interest."

Do they not do that now? I have always noted that from such small dividends as I get there has been something deducted and I do not see what earthly difference this scheme is going to make in that respect.

"... and the treatment of 'charges' on income."

That we concede. Various items of that kind such as life insurances and so on would require some special treatment, but they still have to do that now so that there would be nothing fresh about it.

So much for the body of the report. Then I want to make two or three general observations about the financial implications and then, as I said, leave the detail to Mr. Peacock.

In Appendix I the first item is "Under-estimate of the yield of the present income tax—£214 million." In my submission, that calculation which is explained in paragraph 2 (i) of the Appendix suffers from a major fallacy which shows that the advantage is the other way. The major fallacy is this. It is perfectly true that if you try to look at one year as in a watertight compartment, you can never get all the figures relating to that year and bring them together; if it were correct to look at one year in a watertight compartment there would be something in part of this criticism but, in my submission, it is not correct to do anything of the sort. The flow of income and the flow of tax are like a river. You cannot suddenly dam up a piece of it at both ends and say "We will look at this piece by itself." It is not so. It goes on continuously and any loss there may be in a year of change, owing to the change, is overtaken in the years that follow. Exactly the same thing happened when they introduced P.A.Y.E. They lost the greater part of

22 June, 1951]

SIR ARTHUR COMPTON CARR, K.C., MR. GUY NAYLOR,
MRS. GUY NAYLOR, MR. ALAN PEACOCK, D.S.C., M.C., MISS NANCY SEAR

[Continued]

a year's tax in the first year of P.A.Y.E.; they had to, but they caught it up afterwards. Exactly the same thing is true here. Indeed, if we could have brought our calculations up-to-date they would have come out much more advantageous to the scheme than the year on which we based them. You can see that if you look at the calculations upon which Lady Rhys Williams' totals were based, the figures for the year 1950/1951 worked more favourably to her scheme than our calculations which were based on the year 1948 worked to ours.

385. I do not know that you would have made that statement if you had seen the Board's suggested substituted figure, which shows, I think—I am speaking from memory—rather a larger deficiency on her 1951 figures, than was shown on your 1948 figures. In your last observation you assumed the correctness of her figures. The Board, whether rightly or wrongly, criticised her figures on the same lines that they criticised your own, and made the deficit out to be larger.—That I think is quite likely, in this sense, that the fallacy which they introduce into the calculation will produce larger results the higher the national income rises. It is still a fallacy, and when you are in a period of rising national income, the thing is more advantageous the higher the national income rises, but it is equally true that the higher the national income rises the more difference it will make if you adopt this wholly fallacious process of trying to dam the river at both ends, and ignoring the fact that the flow of income and of tax is a continuous one. You could have condemned the whole P.A.Y.E. scheme out of hand on the same argument—I wonder they did not, but they introduced it. The loss would have been much greater, as shown on the P.A.Y.E. scheme when it was first introduced. These things necessarily catch up as the years go on, and it is in my view a complete fallacy from start to finish to make this sort of calculation at all.

386. Mr. Woodcock: But surely these comments apply to your view also, as you assume that there is in a given year a certain amount of income and an amount of expenditure?—That does not, in our view, affect the finance of the scheme at all. Once you try to deal with one year by itself you are bound to get into the difficulty that you are trying to treat as in a watertight compartment something which is not in a watertight compartment.

387. You can take any period you like, we have got to dam it up at some point. Take the Year I—you make the assumption, not the Board—you assume there will be a revenue in that year certain income, and there will be liabilities against that income, whatever they may be. If you do not collect the whole of the charge for that year you have a deficiency in that year?—I think I will leave Mr. Peacock to deal further with this point in detail. I cannot accept the view.

388. Chairman: If I may interrupt for a moment, I do not want to finish with your statement yet, but you have given us a great deal to think about in the statement you have already made. Mr. Peacock is going to follow you, and I doubt whether he will finish much before 4 o'clock. It will be quite impossible, I think, for us all to ask all the questions we want to of you both, before we have to rise this afternoon. We are meeting again in July, and I wondered if it would be possible, after we have had the opportunity of reading what you have said to-day, for some of you or all of you to come back at our meeting in July, on the 17th, 18th and 19th. I think it will probably be in the interests of everybody that we should complete your two statements and then have an opportunity of considering them. I have not consulted my colleagues, but I do not think we can finish to-day, and I do not think we can get the best out of you without having an opportunity of reading what you have said this afternoon.—My Lord, that will suit us very well. Mr. Peacock would like at this stage to ask a question about that, if he may. Mr. Peacock: Your Lordship, I have been mainly responsible for the figures and calculations made here. There have been certain problems of method, problems of the accountability of figures. I wonder if it would be possible to solicit the co-operation of the Inland Revenue over certain difficulties which we have had in calculation, if the Commission feel that it would be worth while our submitting re-calculations?

389. Yes, I am told that can be arranged.—Sir Arthur Compton Carr: In that case, my Lord, the adjournment would be a matter of convenience. We have only had this document for two days, as you will appreciate, and it would really be convenient for Mr. Peacock to save what he has to say until later. I think he would prefer to reserve what he has to say until the next meeting, when he has had an opportunity of further discussing the figures.

390. Mr. Millard Tucker: Perhaps in the meantime you or the representative of the Inland Revenue could convince each other as to which is right?—Yes. May I then just conclude with a few general observations about this matter? One is that if you look at—I understand Lady Rhys Williams made this point yesterday, therefore I will take it very briefly—if you look at Appendix 2 to the Inland Revenue memorandum it is manifest that, according to them, if the figures are correct everybody or almost everybody will be worse off than he was before. Lady Rhys Williams, I understand, worked that out to a figure of £250 million, yet according to the Revenue, the Exchequer is not going to get that. Where do they suggest it is going?

391. Chairman: I have got some notes as to what they do suggest, but perhaps that also might be discussed later. One thing, of course, which they do point out which affects the matter is that your scheme gives a substantial benefit to employers, mainly companies, by abolishing the employers' National Insurance contribution. That would be one item.—Our scheme does, it is perfectly true, reduce existing taxation in two ways, to neither of which we are necessarily wedded, and either or both of which we would be prepared to abandon if necessary if you should think that the criticisms of the solvency of it as it stands are well-founded. The employers' contribution is one of them. We personally would like to see any contribution that the employers as such have to make to the welfare funds based upon profits rather than upon poll-tax. In periods of high employment and a seller's market, such as we have at present, this is not a serious matter to employers; but if we should ever get back to a period of depression it then becomes a fairly serious matter, to employers who employ large numbers of workers, that they should have to pay what has now become a rather high poll-tax, in modern employment much higher than it was before, whereas people making equally large profits and employing a secretary and an office boy make practically no contribution to these funds in that form. We, therefore, would like to see any contribution which is exacted from employers in respect of this matter, related to profits rather than to the number of people employed, but it is not an essential feature of our scheme and we would certainly prefer to retain the employers' contribution rather than lose the other merits, as we believe them to be, of the scheme. The other point to which I wish to draw attention, in which we have in fact provided for a reduction of taxation and to which we are not particularly wedded, is that we have reduced the margin between earned and unearned income rates; at present it is 1s. 10d., we have provided for only 1s. 6d. If it were restored to 1s. 10d., there is some £53 million in that, or thereabouts. Those are two respects in which our scheme, as drawn, does reduce taxation, apart from its particular purpose, and both of which could be resorted to if need be in order to restore its solvency. I have already pointed out that there are several—and Mr. Peacock will deal with that when he comes to it—several points on which we have not attempted to calculate income, which would undoubtedly accrue to the fund—old age pensioners' earnings, and you will find several others in the notes. Those are the general remarks I wish to make on the financial aspect of it, and I think that concludes what I want to say.

392. Thank you very much. May I just ask you one question arising out of the last remarks? I am not quite clear whether as a matter of principle you desire to retain the employers' contribution, because it had seemed to me, and I put it to Lady Rhys Williams yesterday, that it seemed like selecting one class for a special tax which you were not imposing on anybody else. That was a criticism I made of her scheme. I did not know

22 June, 1951]

SIR ARTHUR COMYNS CARR, K.C., MR. GUY NAYLOR,
MRS. GUY NAYLOR, MR. ALAN PEACOCK, D.S.C., M.C., MISS NANCY SERRAR

[Continued]

whether you were merely saying: "Let us keep this rather than lose the scheme as a whole" or whether you thought it was fair in principle?—We prefer that it should be entirely a matter of tax on profits. If any contribution is required from employers as a class for this particular purpose, we think it is preferable it should be a tax on profits.

393. I suppose it is true to say, is it not, that the loss to the employer would not be as great as it at first sight seems from having to pay this tax, because of course their contributions are a deduction for both profits tax and income tax?—Yes, that is perfectly true. I remember this matter being discussed when the Insurance Act was originally introduced, and the original view was that it was right that the employer should make a contribution in respect of the people whom he employs. I think experience has rather shown, especially when it has become so heavy, that in a period of bad trade it might be a serious deterrent.

394. Mr. Woodcock: The fact that a man requires wages is also a serious deterrent, I suppose?—That is so, I suppose.

395. Chairman: Is there not this comment to be made also, that that is a very good argument when you are regarding it as an insurance which a man pays for himself, but when you take the attitude that he does not pay for it and the social security as a whole is something which should be a charge on the national Exchequer, the reasoning you were on seems to disappear, because it is just something which has got to be paid for as part of the general system of taxation?—Yes, it is a

point on which I know a great deal can be said on both sides, and we are not particularly wedded to any view on it. We would like to see it got rid of, at least in its present form, and if it is to be retained at all, made as a charge on profits.

396. Perhaps I might put one more question before we adjourn, that is this: we were talking about incentives—is it not true to say that in some sense the present system of personal allowances by which you allow £60 for the first child, and so on, as a deduction from the tax, has an incentive element in that too, in that the wage earner wants to get his income high enough up at any rate to get the benefit of that incentive, if he is a married man with a child?—I think it is true that it is very difficult to calculate the effect of these things in that they cut both ways. That is really, I think, the best answer I could make to that. I can see almost anything cutting both ways in the matter of tax and incentive, except that I think once you get into a graduated rate where a man suddenly finds he is going to pay a much higher rate if he takes extra trouble to earn more, that is a thing which you can say is definitely disincentive. I think with regard to all the other aspects of it there are arguments both ways.

397. Chairman: Then we will adjourn now. We are sitting again on the 17th, 18th and 19th July, but we would like to complete our evidence on this branch of the subject as soon as we can; will 17th July, at 10.30, be convenient to you?—For me personally the 18th would be more convenient than the 17th.

Chairman: Then we will make it the 18th July, at 10.30.

The witnesses withdrew.

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ROYAL COMMISSION ON THE TAXATION OF PROFITS AND
INCOME

MINUTES OF EVIDENCE 3
TAKEN BEFORE THE
ROYAL COMMISSION ON
THE TAXATION OF
PROFITS AND INCOME

THIRD DAY

Wednesday, 18th July, 1951

WITNESSES

SIR ARTHUR COMYNES CARR, K.C.	} The Liberal Party	<i>Questions 398-560</i>	
MR. ALAN PEACOCK, D.S.C., M.C.			
MRS. GUY NAYLOR			
MRS. NANCY SEEAR	} The Board of Inland Revenue	<i>Questions 561-781</i>	
MR. F. A. COCKFIELD			
MR. R. E. BEALES	} The Ministry of National Insurance		
MR. G. M. WILLIAMS, C.B.E.			
MR. R. U. L. EDWARDS			



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TERMS OF REFERENCE

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages: to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer: to consider the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden fairly among the individual members of the community: and to make recommendations consistent with maintaining the same total yield of the existing duties in relation to the national income."

NOTE

For the guidance of intending witnesses the Commission published a list of the main heads under which evidence was invited. They explained that the list was not necessarily exhaustive and that witnesses could put in evidence on questions not specifically mentioned, provided that they fell within the Commission's terms of reference. The list is reproduced below.

A. General social and economic questions

1. Is the present system of taxation satisfactory, or could it be improved, in relation to:—
 - (a) incentives,
 - (b) risk bearing,
 - (c) encouraging savings,
 - (d) the control of inflationary or deflationary tendencies,
 - (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment,
 - (f) its effect on the distribution of personal incomes,
 - (g) other economic and social objectives?

These questions can be considered in relation to the taxation of:—

- (i) salaries and wages (P.A.Y.E.),
 - (ii) profits of businesses and self-employments,
 - (iii) dividends and other sources of income.
2. Would it be advantageous to link Income Tax with social security payments and contributions?
 3. Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

B. Particular matters

4. Is the taxation net drawn too widely or too narrowly in relation to:—
 - (a) the taxation of United Kingdom residents (companies or individuals) on overseas profits,
 - (b) the taxation of non-residents on United Kingdom profits,
 - (c) the definition of residence, etc.?
5. (a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particular—
 - (b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?
6. Is the basis of computing income from property under Schedules A and B satisfactory?
7. Should the present rules about deductions for outgoings and expenses be altered?
8. Are the provisions for relief in respect of double taxation satisfactory?
9. Should the present system of graduation by means of the exemption limit, personal allowances, reduced rate relief and Surtax be altered?
10. Should the existing differentiation between earned and unearned income be extended or reduced?
11. Are alterations necessary in the rules governing personal and other allowances?
12. Should the rules about the taxation of husband and wife be altered (a) as regards aggregation; (b) in any other respect?
13. Should P.A.Y.E. be altered or abolished?
14. Should the principle of deduction at source be extended or restricted?
15. Should the method of assessment to Surtax be altered, and in particular should it be deducted from salaries?
16. Are any alterations desirable in the system of administration and the functions of the various statutory bodies or persons connected with taxation?
17. Are any changes in the provisions against avoidance and evasion desirable?
18. Is any alteration necessary in the rules governing the taxation treatment of special classes of taxpayers (e.g., public corporations, co-operative societies, charities)?

MINUTES OF EVIDENCE TAKEN BEFORE

THE ROYAL COMMISSION ON THE TAXATION OF PROFITS AND INCOME

THIRD DAY

Wednesday, 18th July, 1951

PRESENT:

The Rt. Hon. Lord Justice COHEN (*Chairman*)

Mrs. VERA ANSTEE, D.Sc.

Mr. H. L. BULLOCK

Mr. W. S. CARRINGTON, F.C.A.

Mr. W. F. CRICK

Sir HARRY GILL, J.P.

Mr. J. E. GREENWOOD

Mr. J. R. HICKS, F.R.A.

Mr. N. KALDOR

Mr. W. J. KESWICK

Miss L. S. SUTHERLAND, C.B.E.

Mr. J. MILLARD TUCKER, K.C.

Mr. G. WOODCOCK*

Mr. B. R. BROOKES (*Secretary*)

Mr. D. G. DAYMOND (*Assistant Secretary*)

* Present only for the evidence of The Liberal Party.

Sir ARTHUR COMYNS COKE, K.C., Mr. ALAN PEACOCK, D.S.C., M.C., Mrs. GUY NAYLOR and Miss NANCY SEAR, on behalf of the Liberal Party; called and examined.

SUPPLEMENTARY MEMORANDUM SUBMITTED BY THE LIBERAL PARTY

I. INTRODUCTION

(a) The purpose of this memorandum is twofold. The first part sets out revised figures for the Liberal Scheme in accordance with principle agreed upon between the Inland Revenue, Lady Rhys Williams and Mr. Alan Peacock regarding the method of calculation of tax rates and benefits. As a consequence of the willing co-operation of the Statistics and Intelligence of the Inland Revenue, and in particular Mr. Cockfield and Mr. Beales, it is possible to present figures which make it unnecessary for us to dispute the basis of calculation. In the second part, some observations are made regarding paragraph 25 of the Inland Revenue Memorandum for it suggests that the abolition of the contributory system would have certain drawbacks from the point of view of the finance of social security.

II. THE SOCIAL SECURITY BUDGET

(a) The important question to be answered regarding the Liberal scheme is, would it be possible to balance payments and receipts without at the same time introducing a higher standard rate of tax or alternatively paying benefits which would compare unfavourably with those already in existence? The following calculations show that it is possible to retain the tax rates originally proposed in the Liberal Party Yellow Book provided that we do not implement the proposal in Section 80 of our report, viz. that wives of pensionable age should be paid the same pension as husbands of pensionable age. It is, however, still possible for us to pay benefits to single and married couples of pensionable age which compare favourably with those in existence in the year 1950, the year for which the calculation is made.*

(b) In Table I the budget of the scheme is drawn up. A slight modification has been made in the procedure adopted in Schedule I of the Yellow Book. We make it clear in the report that we would continue to pay existing rates of maternity benefits and grants, death grants etc., Industrial Injuries benefits and National Assistance where necessary and, of course, the National Health Service is not affected by the scheme. Accordingly, expenditure for these items is included in the contribution to general government expenditure and not as part of the supplementary allowances.

* Other adjustments are possible. The rate of tax on unearned income might be raised or the employers' contribution reduced.

TABLE I.

STATEMENT OF INCOME AND EXPENDITURE		
	<i>Income</i>	<i>£m.</i>
1. Income Tax		
a. At 5s. on £8,150m. of earned income...		2,037.5
b. At 6s. on £1,367m. of unearned income ...		410.1
c. At 6s. on £1,175m. of undistributed profits ..		352.5
2. Supplementary Tax		
a. At 2s. on £900m. of earned income ...		90
b. At 3s. on £450m. of unearned income ...		67.5
c. At 3s. on £1,175m. of undistributed profits...		176.25
		<hr/> 3,133
Addition to Profits Tax		16
Total Income		<hr/> 3,149
	<i>Expenditure</i>	<i>£m.</i>
3. Personal Allowances		
39m. adults at 12s. 6d.		1,267.5
11m. children at 12s. 6d.		357.5
4. Supplementary Allowances		
1-6m. unemployment, sickness and widows' benefits at 20s. in addition to personal allowance		84
4m. retirement pensions at 20s. in addition to personal allowance		208
5. Contribution to Government Expenditure ...		1,161
6. Balance to cover life insurance relief etc. ...		71
Total		<hr/> 3,149

Notes on Table I.

1. The figures on the Income side are based on data provided by the Inland Revenue and the procedure in calculation is that adopted in the original Appendix, but more accurate data has been made available by the Inland Revenue.

2. The "Addition to Profits Tax" requires some explanation. The abolition of the employers' contribution means that gross profits increase by £166m. This is taxed at 10 per cent. and the residue is added to undistributed profits and taxed in accordance with the rates in Table I. Thus this £16m. represents 10 per cent. of £166m. so that £156m. is added to undistributed profits.

3. The procedure on the Expenditure side is similar to that in the original calculation except for a change in book-keeping which is explained in paragraph 115 of this Memorandum. The Contribution to Government Expenditure is arrived at by summing

19 July, 1951]

SIR ANTHONY COMYNES CARR, K.C., MR. ALAN PRADOCK, D.S.C., M.C.,
MRS. GUY NAYLOR AND MISS NANCY SIEAR

[Continued]

Income Tax in 1950 plus Tax Reserves plus Surplus on Insurance Funds minus Savings (such as Interest on National Debt held by Funds, Subsidies, family allowances and non-contributory pensions). No deduction is made, of course, for other transfer payments which would be recognised such as maternity benefits, death grant etc. and for the National Health Service.

4. No allowance is made for administrative saving of any kind nor for the fact that, if the scheme were to conform to present practice, then personal allowances would not be payable to members of H.M. Forces and their dependents nor to persons in institutions such as prisons and mental hospitals, nor is any allowance made for the yield of tax on pensioners' earnings, were the scheme to encourage more pensioners to work in view of the fact that their pensions would not be reduced if they did so. Accordingly, the balance available for tax relief of the kind mentioned in Appendix 1 of the Inland Revenue Memorandum might be considerably larger.

(c) In Table 2, the attempt has been made to show how

the Central Government Revenue Account (Table 20 in the White Paper on National Income and Expenditure, Cmd. 8203/50) would have been modified, had the scheme been in operation in 1950. For the purpose of exact comparison, it is necessary in considering the actual totals for 1950 to consolidate the Central Government Revenue Account with the accounts of the National Insurance Funds, for the taxes raised under the Liberal scheme replace in part the contributions paid by employers and employees. Of course, this procedure makes no allowance for the fact that, had the scheme been in operation, tax receipts and payments other than income tax and social security benefits might have been altered as well, e.g. indirect taxes on consumption goods. As these effects cannot be estimated, it has been assumed that they would have remained unaltered, or that changes in tax receipts would have been exactly offset by changes in expenditure.

TABLE 2
REVENUE ACCOUNT OF CENTRAL GOVERNMENT

(Consolidation of Table 20 and Table 24 of White Paper on National Income and Expenditure of the U.K., Cmd. 8203/51. Original figures are in brackets).

Receipts	£m.	Payments	£m.
I Direct Taxes on Income		VII Current Expenditure on Goods and Services	
1. Income Tax	2,954 (1,609)	VIII Subsidies	1,441 (1,441)
2. Surtax	116 (116)	IX Social Security Benefits	127 (446)
3. Profits Tax	280 (264)	X Other Transfers	2,062 (608)
4. Excess Profits	13 (13)	XI National Debt Interest	137 (137)
5. Miscellaneous	5 (5)	XII Grants to Local Authorities	511 (511)
	3,358	XIII Transfers to Capital Account	352 (352)
II Capital Taxes	188 (188)	XIV Surplus	145 (145)
III Indirect Taxes	1,743 (1,743)		652 (652)
IV Income from Property	138 (138)		
V Employers and Employees Contributions	(413)		
VI Total Receipts	5,427 (4,290)	Total Payments	5,427 (4,290)

Notes on Table 2.

1. In the Revenue Account of the scheme, the following points require elucidation:—

(a) 1. 1. Is total yield on tax, minus tax reserves, minus balance to cover life insurance relief, etc. These items have been brought over from the other side of the account and their signs changed.

(b) 1. 3. Profits Tax is adjusted upwards by £16m. in accordance with our budget estimate.

(c) VIII. We reduce subsidies by £17m. (£444m. minus £317m. equals £127m.).

(d) XIV. Surplus equals Government revenue surplus plus insurance funds surplus, both of which must be covered by surplus.

2. In the Consolidated Accounts of Table 20 and Table 24 of Cmd. 8203/51 the following adjustments have to be made:—

(a) The contribution from the National Insurance Funds to the National Health Service operates on both sides.

(b) Item 28 on Table 20 (Eschequer contributions to National Insurance Funds) is replaced by the benefits payable under National Insurance plus administrative costs. These items are included in IX of our table. Accordingly employers' and employees' contributions are included in receipts (V).

(c) National Debt Interest (XI) is reduced by £13m. (i.e. by the amount payable by the Treasury to the National Insurance Fund).

(d) Current Expenditure on Goods and Services (VII) is reduced by £17m. This is because the statisticians who compiled the Command Paper omitted to include the Government contribution as employer in Item 28 of the original table. Accordingly as VII (Item 22 in the original table) is a balancing item, the total expenditure is reduced from £1,668m. to £1,441m.

III. THE ABOLITION OF THE CONTRIBUTORY SYSTEM

(a) One of the main changes which would be brought about by the scheme would be the abolition of the contributory system. It is a matter of surprise that the Inland Revenue in paragraph 25 of their Memorandum should quote Lord Beveridge without comment in support of the contributory principle. In paragraphs 272-276 of the Beveridge Report in which the question of taxation v. contributions is considered, no detailed criticism

is made at all of the finance of social insurance by taxation. It is pointed out that there would be disadvantages in the introduction of an "ear-marked" tax for the purpose of financing benefits in view of the history of the Road Fund (presumably Lady Relys Williams' "Welfare Tax" would be regarded as such a tax). This is a curious objection, for there could be no better example of a system of ear-marked taxes than insurance contributions! They are first of all taxes because they are compulsory; the employees' contribution is a regressive poll-tax and the employers' contribution is an indirect tax. The system of compulsory contributions is thus open to Lord Beveridge's own objection.

(b) Another important point is that the employees' and self-employed persons' contribution is only about $\frac{1}{4}$ of the total revenue:—

	1938	1947	1948	1950
1. Contribution of employees and self-employed	55	119	176	242
2. Total Revenue	145	350	505	628
3. Lower 2	33	31	35	38

This proportion is likely to decrease as the cost of pensions rises unless the contribution is increased. Therefore the relationship between the contributions of beneficiaries and the benefits is scarcely that of an insurance system.

(c) Accordingly, so far as the present scheme is concerned we are considering the relative merits not of taxation and the contributory system but of two different forms of taxation. In the sense that the term "insurance" is applied to the provision of social security benefits it is just as applicable to other forms of Government expenditure. Defence expenditure is just as much "insurance" in this sense.

(d) Regarded in this light then, the arguments advanced in favour of the contributory principle in paragraph 274 of the Beveridge Report and which are quoted without comment in the Inland Revenue Memorandum seem particularly weak.

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As regards (b), we have shown that it is possible through our scheme to abolish the means test and the contribution at the same time. It is also questioned whether the payment of a regressive poll-tax is equally acceptable to all insured persons, especially as the tax is higher than that originally proposed by Beveridge.

The contributory system is not the only one which would make beneficiaries interested in economic administration. In this sense our scheme would do the same. However, under the present system, the illusion is created that the employers' contribution finances the scheme and it was previously often believed that it financed the Health Service as well. To make people believe that National Insurance finance is independent of Government finance need not necessarily promote an interest in economic administration (although in fact administrative costs have been relatively low) but a desire to increase benefits *pari passu* with the increases in the reserves held. The belief that the Insurance Scheme holds "colossal" reserves induced old-age pensioners to believe that their deserving case was strengthened by the buoyancy of insurance finance. This is a dangerous illusion which is fostered by the convention of maintaining National Insurance accounting separate from Government accounts.

There is another confusion which results from the contributory system. It is not clear to the contributor that as well as paying his insurance contribution he also contributes as a tax payer to the Government contribution to the scheme, and if the employers' contribution is passed on in higher prices, he helps to pay for it as a consumer. Under the Liberal scheme the tax liabilities of the tax payer are made perfectly clear to him.

As regards (b), this argument only holds if the system of administration is necessary in the first place. The payment of positive allowances removes the necessity for the keeping of records of this sort.

Finally, there are two further consequences of our scheme that call for comment. It would mean the abolition of the National Insurance Funds. This is no cause for alarm. The "reserves" held by the Fund are held in Government securities; in consequence, all that happens

is that the Government cancels debt held against itself. Let us imagine what would have happened if the Government had decided to finance increased pensions by selling the securities held by the Funds. The cash to finance benefits would have to come from those willing to buy the increased supply of Government securities. The banks would only do so if their cash ratio were expended, i.e. the sales would involve a credit expansion at a time when the Government might wish to restrict credit. The public will only take up the stock at the current rate of interest if it increases its desire to save. In other words, sales of securities by the Funds have the same consequences as a policy of government borrowing. Accordingly, the finance of increased pensions involves exactly the same problems as the finance of other items of government expenditure and it is no wonder that the Chancellor made it clear that the recent increases in pensions were granted on grounds of the merits of the pensioners' case and not on grounds of the buoyancy of the Insurance Funds.

The abolition of the contributory system would mean that the Treasury would be unable to put into operation the much-publicised contra-cyclical device outlined in the White Paper on Employment (1944) and embodied in Section 3 of the National Insurance Act, 1946. This section allows the Treasury to alter the contribution rates "with a view to maintaining a stable level of employment". However, this type of contra-cyclical financing would be carried out with much more effect with the proposed Liberal scheme. As Professor Meade says of the Rhy's Williams proposals (and the statement applies equally to the Liberal one), "the system would afford a perfect instrument for the most effective and prompt control over total national expenditure in the interests of avoiding inflation and deflation" (Planning and the Price Mechanism, p. 44). Even a small alteration of the standard rate of tax would affect the incomes of millions of tax payers; in our scheme a reduction of the standard rate on earned incomes from 5s. 6d. to 4s. 6d. would increase the amount of spendable incomes of earned income receivers by over £100 millions.

It is submitted, therefore, that as a system of taxation the Liberal scheme is much more equitable and efficient than the contributory system.

EXAMINATION OF WITNESSES

398. Chairman: We have all had the opportunity of reading your evidence and the first thing I am going to say to you is that I hope, if some of our questions appear critical, you will not think we have become partisan?—*Sir Arthur Comyns Curr*: No. Might I ask you, for personal reasons, to take Mr. Peacock's evidence first because he has to get away if he can.

399. So be it. I will try to sort out the questions I had prepared for you and find those which are directed to figures, which I suppose is what Mr. Peacock is going to deal with?—*Yes*. You have seen, I hope, a further statement of corrected figures which Mr. Peacock has prepared and that is the subject of his evidence.

400. Yes. I have some questions to ask on that, but before I do so there is one thing I want to make clear. You will appreciate, of course, that we are appointed to deal with the question of the taxation of profits and income?—*Yes*.

401. We are not concerned with the merits or demerits of social security as such?—*No*.

402. Your scheme goes into both aspects, but it must not be thought that because I ignore certain parts of your memorandum I am expressing assent or dissent; it is simply that I do not think, in so far as there is an interrelation between that and income tax, it would be proper for us to express an opinion on the point and therefore I shall not waste your time by asking questions on it.—I appreciate that, my Lord. Of course, there is the financial aspect of it which does affect the taxation proposal.

403. Certainly. If you wish me to address such questions as I want to ask directly affecting Mr. Peacock, I will commence with your supplementary memorandum and the first question I want to ask you about that

appears in Table I under "Addition to Profits Tax". As I understand it, that item represents 10 per cent. on a figure of £160 million which you say will no longer be deductible from profits because the employers' contribution will not be payable. Is that right, Mr. Peacock?—*Mr. Peacock*: Yes. As the personal employer's contributions are added to gross profits, that is taxed at 10 per cent., and therefore we have included this small amount.

404. The point I want to put to you is this. That depends upon the assumption that the £160 million will be added to gross profits and that no part of it will be employed in reducing prices, does it not? Where firms have savings, sometimes at any rate they take the opportunity of reducing prices in the hope of indirectly benefiting in other directions, but you are assuming the whole of it will go into gross profits?—I admit the argument is "other things being equal". It would be an addition to gross profits. I did mention this matter to Mr. Beales of the Inland Revenue and asked him if it would be legitimate in this case to add it on to income and he agreed with me that it was. I agree, however, that it is "other things being equal".

405. It depends upon the whole of the saving effected being treated as profit and not applied to other purposes which would make it deductible?—*Yes*.

406. In the next question I am putting to you I am omitting the half-a-crown which you add on to the benefit to compensate for the reduction of subsidies, because the reduction of subsidies is outside our reference and therefore I am treating the amount of your allowances as being 10s. and not 12s. 6d.—Am I to take it, my Lord, that the subsidies are not regarded by the Commission as social security payments?

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407. No, no, they are regarded as social security payments, but it would be quite outside our Terms of Reference to recommend a reduction of subsidies. As I understand both your scheme and Lady Rhys Williams' scheme, you recommend an allowance of 12s. 6d., of which half-crown is intended to represent compensation for the reduction of subsidies; is that not right?—In that case it is, in fact, a money subsidy substituted for a reduction of prices at such; there is no reduction in the subsidy to the consumer.

408. Yes, but if you retained the subsidy you would only recommend a weekly allowance of 10s.?—That is correct.

409. Therefore, I am putting my questions on the basis of a weekly allowance of 10s. and, with that in mind, I want you to consider the last sentence in your paragraph II (a):—

"It is, however, still possible for us to pay benefits to single and married couples of pensionable age which compare favourably with those in existence in the year 1950, the year for which the calculation is made."

Am I right in thinking that married couples of pensionable age at the present time get 42s. a week?—In 1950, that is correct.

410. Under your scheme, if I have followed it aright, they will get not 42s. but 40s.?—Well, they will get that as a retirement pension but they will also get their personal allowances as well, that is, under item 3.

411. No, no; they will get their personal allowances which amount to £1 and they will only get one retirement pension. Read your previous sentence.—I regret it is obscure to your Lordship. So far as we have calculated pensions in this respect, taking for the sake of argument a person over the age of 65, he will get his personal allowances of 12s. 6d., or as you say 10s., and in addition to his personal allowances he will receive the retirement pension. The total money subsidy is therefore higher than the existing rate.

412. I cannot make out how you arrive at that figure. Twice 10s. is £1, is it not?—Yes. When we say "It is, however, still possible for us to pay benefits", we do not say to pay what we call here a retirement pension which is additional to the personal allowances.

413. No, they will get twice 10s., i.e., £1 and one retirement pension of 20s., making a total of 40s., because you have said in the previous sentence:—

"Provided that we do not implement the proposal in Section 80 of our report, viz. that wives of pensionable age should be paid the same pension as husbands of pensionable age."—That is correct.

414. Therefore, as I understand it, the married couple would get one retirement pension plus two weekly allowances?—Two weekly allowances plus one retirement pension.

415. Yes, which is 40s.—I wish to point out, if I may, at this stage, although we have not had very much time in which to do these calculations, that it might be possible, in view of further information we have received, to adjust this figure, as we had hoped to do in the original report in 1948, back to retirement pensions for all persons both male and female.

416. I can only deal with what is before me, of course.—Yes. I just wanted to make it clear that these figures are illustrative. It is true that if one regards the half-crown as a substitute for the subsidies, this is a combined pension for a married pensioner of 40s., that is, one retirement pension of 20s. plus two weekly allowances of 10s.

417. Therefore, on that basis there would be a loss of 2s. a week to the married couple?—Yes. That is, of course, on the assumption that in this case, as at present, the married woman pensioner would not be entitled to a pension in her own right.

418. Supposing you were to feel, as you might well feel, that it would have a disincentive effect to give less and you increased that figure, for instance, by making the retirement pension in the case of a married couple 22s. so that they should not get less than they are getting at present, that would cost, so I am told, another £10

million.—That is a possibility. In order to compare them, if it were to cost an extra £10 million, then on the basis of allowing for the fact that apparently we have over-estimated the amount of tax reserves which should be charged against income, we should be able to refore that 2s.

419. I am going through table I in a moment. I think you will find the saving on tax reserve is more than swallowed up by errors elsewhere. I am only just seeing where we are getting; I am not saying it is fatal to the scheme, but I am trying to see if we can get to agreed figures.

Regarding table I, I do not think I have any comments to make on the Income side of it, but if you will turn to the Expenditure side, I am told that, according to the latest figures, you have under-estimated the population by over half-a-million and that if you paid that half-a-million 10s. a week it would cost another £16 million. On the other hand, I am told that no deduction has been made for the fact that, as you have pointed out in note 4, you have allowed for pensions for people in institutions such as prisons and mental hospitals and I am told that if you omitted pensions to them, as probably everybody would agree they were not payable, it would save, so to speak, £5 million. Therefore, there is an error of £11 million on that item. I suppose the figure of over half-a-million is right and you cannot challenge that as a figure?—I take it that is the latest population estimate given in the recent report.

420. The next figure which is challenged and this is a much more serious item from the balance sheet point of view is your figure of 4 million retirement pensions. I am told the proper figure is 4.8 million. You appear to have omitted women over sixty who have neither husbands nor pensions at the present time. I am told that the cost of providing £1 per week for those 800,000 people would be £42 million. I do not know if you have any comments to make on that?—I have no comments to make on that. I adopted this figure, a figure which was given to me at the time by Mr. Cockfield. It was a misunderstanding. I feel I should have challenged that figure and I am entirely to blame for that.

421. On the other hand, as you said just now, you have over-estimated the tax reserves and I did not quite know how it was made up. Mr. Cockfield tells me you have over-estimated, after making the additions referred to in note 3, the contribution required to Government Expenditure by a sum of £24 million. In other words, there is a saving there. I am told that the proper figure is £1,161 million. Then I am told that the figure you gave me as the figure required to cover life insurance relief, etc., should be £90 million and not £71 million and therefore there is £19 million wrong there. It rather looks as if the £71 million was put in not because of any calculation but as what accountants call a balancing item?—That is correct.

422. Let us now see where we have got. I am going to assume, first of all, that we cannot give married people a retirement pension of less than the 42s. they have got now; that would cost an extra £10 million. Your under-estimate of the population would cost a further £11 million. Your under-estimate owing to the omission of women of the category I have described would cost £42 million and the correction of item No. 6, "Balance to cover life insurance relief, etc." would involve £19 million, and all that makes a total of £82 million. On the other hand, there is a saving of £24 million on item 5, "Contribution to Government Expenditure" and I am told that the net under-estimate is £58 million, or rather the deficit on table I. If you want to challenge that figure, please do so, or, if you do not feel it is a position to do so now it is, of course, always open to you to write to the Secretary later on.—There is only one point, my Lord, I understood the over-estimation of the Reserve was £34 million and not £24 million. I do not know if I am correct in saying that.

423. Mr. Cockfield is going to be called after you have finished your evidences. I gathered that he had some difficulty in arriving at how the various items were made up. He says that the correct aggregate figure is £1,137 million. I will try to get from him how that is arrived at, so far as he can give it, when he is here.—I have here

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full details of item 5 "Contribution to Government Expenditure", which I got from Mr. Cockfield. Sir Arthur Comyns Carr: Could Mr. Peacock hand in that document because it will assist you when Mr. Cockfield is called if you have the details before you? (Document handed in; reproduced at page 59.)

424. Thank you. The only other question I want to ask you on that part of your supplementary memorandum is this. I have, so to speak, to make the balance sheet balance and if £53 million is the deficit which you require, on the basis of the gross income, and you talk in table 1 of £8,150 million of earned income, the additional tax amounts to 14d. in the £. That is not a very large addition to the 5s. you recommend and, of course, it does not sound much when you put it in 14d. in the £, but I am told, and I should like your help about it if it is not right, that even 14d. in the £ makes a difference of £3 per year in the spending money of a single man enjoying an income of £350 per annum?—Mr. Peacock: Yes, on the assumption, for instance, that the employer's contribution is not restored, which is an alternative. May I point out with regard to item 4 in table 1 that it is possible there might be a considerable saving in the allowances paid to dependants of H.M. Forces.

425. I am coming to that in a moment and that was the next point I was going into with you. I gather you propose, and *prima facie* it would seem right, that members of H.M. Forces and their dependants should receive the weekly allowances. I suppose also in that event, and no doubt this has been taken into account, they would suffer deductions from their pay of 5s. in the £?—Yes. I understand that deductions for the existing allowances are included in our calculations of tax.

426. I am told that if you omitted His Majesty's Forces altogether, that is to say, if you did not charge them 5s. in the £ on their pay and did not pay them any allowances, the net result would be an increased deficit and not a reduced deficit.—Yes, I should expect that.

427. You could hardly charge them the tax on their pay and not let them and their dependants receive the allowances, could you?—At the moment they are paying towards family allowances, children's allowances, and, as far as I understand it, they are not receiving family allowances from the Ministry of National Insurance for their children.

428. Would you regard it as an improvement to perpetuate that state of affairs?—No, sir. I am purely concerned in this case with the balance sheet. I agree it might not be desirable to perpetuate that state of affairs.

429. Perhaps Sir Arthur would like to intervene at this point to say whether he would regard it as an improvement. Of course, it is impossible to segregate figures exactly, but the point I was putting was this: it is not a matter of figures, it is a matter of principle; whether it would be right to charge your 5s. in the £ on the pay of His Majesty's Forces and not let them and their dependants receive the weekly benefits?—Sir Arthur Comyns Carr: I should say obviously not; they should either be left out altogether or they should come in on both sides of the sheet.

430. I suppose the fewer people you treat differently from others the better?—Yes.

431. And preferably one would include them?—Yes.

432. I do not think that there are any other questions I want to ask which are purely on the figures. I do not know whether you would regard this as a question on the figures or as a question of principle, but you will remember that in the course of his evidence Sir Arthur commented on paragraph 35 of the Board of Inland Revenue's Memorandum. His observation began with the words: "Well, well", but I cannot find it for the moment.—I propose to revert to that and add to it if I am permitted to do so.

433. I do not know whether that particular point was discussed when you were discussing the matter with Mr. Cockfield?—Mr. Peacock: That particular point was not discussed.

434. You appreciate that in paragraph 35 what they were dealing with was incentive and I think the point they were making was this, that whatever the position as regards

the National Insurance Contributions, the fact remained that six million people who at present pay nothing would under your scheme get only 15s. in the £ for every £ they earned. That must be so, must it not?—Sir Arthur Comyns Carr: That is so, my Lord.

435. That is bound to have a disincentive effect, is it not?—There I respectfully disagree. They are only suffering the tax in that form. They are, on the other hand, escaping the flat rate insurance tax and furthermore they are getting the allowances in direct payment which were formerly deducted from their taxable income which was, in turn, the reason why they did not pay any tax. As I have pointed out, we say that the low paid man is much worse off under that system.

436. I think I am right in saying that a man with three children who gets £480 a year pays no tax at all at present, so he would be one of them because in round figures in future he would pay £120 in tax, under your system, that is to say at 5s. in the £?—Yes.

437. He would draw five times 10s., i.e. £2 10s., so that he would be very slightly better off, but of course what he would notice first of all would be that his pay packet would contain less, would it not?—His own pay packet, yes. If you take the case of a man with three children, his own pay packet, even if he took his own weekly benefit from the tax, would contain less.

438. Very much less.—But his wife, he or his wife, would draw on behalf of herself and the children more than the difference.

439. I imagine you would not suggest it would be desirable that he should draw directly or indirectly his wife and children's money?—No, not at all events directly.

440. From the social point of view as distinct from the disincentive point of view, it must be a bad thing for the money not to go to the mother?—Yes. I was only including him in cases where there happened to be no mother.

441. I think that is all I wanted to ask you purely on the figures, but, as Mr. Peacock has to go I will ask any of my colleagues who wish to ask him questions on the figures to do so now, before I return to the charge against you, Sir Arthur?—Certainly, Sir.

442. Mr. Hicks: Might I raise a question which is not very directly concerned with your supplementary memorandum but goes back to your original book; but in the first place I want to ask you how far these tables at the end of your original book showing the effect on people at particular income levels of the scheme as first calculated still stand in the light of the alterations made in your supplementary memorandum? I take it that, on the whole, they do stand?—Mr. Peacock: They do stand.

443. They are essentially not affected?—They are not affected provided you still have the tax rates of 5s. and 6s.

444. Then I want to raise with you a question which I put to Lady Rhys Williams and which I think really does apply to your figures. It is this. It does seem very extraordinary that there are so many places in the last column and so few minutes. One knows that the number of people who get the big places, e.g., some of the people with the higher incomes, is quite small and that helps to explain it; nevertheless, I think one is right in saying there are not enough minutes to balance the places in that last column and something therefore needs to be explained because this is essentially a re-distributive scheme, apart from the savings in cost of administration of which I take it no great account has been taken, and therefore, on balance, somebody must lose for somebody else to gain. What is your view about the answer to that. We had some further remarks on that from Lady Rhys Williams in her second memorandum. I do not know whether you have seen that?—I have not seen the latest paper from Lady Rhys Williams. My explanation is this. It is true that this may seem rather baffling. I have tried to get the figures, I tried to weight these various groups, but it is of course extremely difficult. I can only suggest the point Mr. Hicks has already mentioned, namely, that there must be a large proportion of wage earners who are single men or women with incomes up to £500 per annum and a large number of married couples without dependants in the income groups, £300, £400-£500. That I should say is a quite reasonable explanation of this, that there is in fact a considerably greater proportion of wage earners in those particular

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groups. I should have thought that was quite a reasonable explanation and that if one wanted to balance the "better-offness" or the increase in wealth, one might have to take into consideration the weightings in the various income groups.

445. But you have not checked it up, because it is definitely included as part of your scheme that, so far as benefits are concerned—unemployment and health, and all the rest of it, no-one should be worse off than at present?—Yes. Of course, one must remember that, I think I am right in saying, even under the present system there is very little of what one might call vertical redistribution from rich to poor and in this connection we have tried to make the re-distribution selective and we have selected particularly those persons with children. I have received from Miss Sear the figure that in 1947, 56 per cent. of households had no dependent children. That would surely possibly explain the weightings for item (B), married couples without dependants.

446. Mr. Kildor: I happen to have some figures here which purport to show that out of a total number of persons of 50 million there were roughly 20 million taxpayers and if you take the category of under £250 a year, then out of a total number of persons of 16.7 million there were 8.7 million taxpayers and if you take the category under £135, then out of a total number of 3.8 million there were 2.8 million taxpayers, so that there is some difference in the proportion. I think those figures bear out what you have said, that the number of single persons or persons without families is larger in the low income categories, but I do not see that the proportions are so different as to be capable of explaining Mr. Hicks' point. I think what one ought to do is to try to multiply these figures to see what happens?—That is the only explanation I can offer.

447. Then there is just one small matter, which the Chairman has already raised: you would agree, would you not, that the employer's contributions to social insurance schemes is in every way similar to a tax on commodities in its economic effects; it enters into the prime cost of production of industry?—I should say yes, certainly under present conditions. If one is concerned with tax incidence, under present conditions I should regard it as a tax on consumption.

448. In other words, it is a tax which tends on the whole to be fully passed on to the consumer, like the tax on tobacco?—Yes, I would agree with you.

449. Chairman: Now, Sir Arthur, I am going to return to the charge on general questions, first of all.—I do not know if you would allow me first of all to elaborate somewhat on the point I made regarding the disincentive effect of P.A.Y.E. and also to correct one or two errors I made last time or whether you would prefer to do that by question and answer.

450. I would rather you did it straight away. I may save some of the questions I want to put to you.—I thought it would probably be quicker. The first point I wanted to make has to do with rebates under P.A.Y.E. We do submit that this rebate system has an extremely disincentive effect, as well as the jump in rate of tax. The rebate system, I understand, works in this way, that when you have paid a certain amount of tax you can, by abstaining from work or by working less in a subsequent period get back some of the tax which you have paid. All of us, of course can avoid paying income tax by the simple process of not earning any income, but it is only under the P.A.Y.E. system that you can get back tax which you have actually paid.

451. That is only because you have paid more than your liability, on the facts as known at the end of the year?—Yes, but it is an obvious temptation to some people, in fact it is a temptation to everybody but it is one which some people are unable to resist, to have what I may call a second holiday with pay at the expense of the income tax. There is nothing wrong about it, but it is an obvious disincentive.

452. Rebates is hardly the right phrase, is it? It is a repayment.—Yes, repayment. It is called a rebate but it is in fact a repayment. You can, after you have accumulated a certain credit of tax paid, get some of it back again by abstaining from work in a later period, particularly at the end of the tax year. I am told the month of

March is the one in which this occurs most frequently, although I understand it can be done at any time. That has a disincentive effect, I think, and one which would be removed by the change of system we propose.

Another point I wanted to make, and it is really a question you have already asked me about, occurs at Question 379 in my comments on paragraph 35 of the Inland Revenue memorandum. I wanted to strengthen that point by drawing attention to the fact that the Inland Revenue have omitted unemployment and national health insurance contributions and also the allowances which we propose which in effect take the place of these very personal allowances and reliefs which under the present system enable the people mentioned in paragraph 35 not to pay any income tax; hence, in our view, the comparison is doubly mistaken on that ground.

The only other matter is the question of these tax reserves, which appears at Question 384. I expressed the view that you could not regard it in watertight compartments, but you must regard it as a river continually flowing. To some extent, I still think that is correct, but it would be more correct to put it in this way. The criticism of the Inland Revenue is true as long as what I may call the national paper income keeps on rising, i.e., as long as we have inflation. That rise is partly due to inflation and partly to increased production and as long as we have both those factors that criticism is true, i.e., that you will always be a couple of years behind as to the particular part of the tax which comes from business sources and that will mean you will always be short: but if you were in a period when the national paper income was stationary then there would be no difference, it would be all square in every year. If, on the other hand, you were in a period when the national paper income was falling, that is to say, if we ever got to the stage when inflation turned into over-production, it would then operate in favour of our calculation; the tax in that particular year would produce more than we have shown instead of less.

453. But surely, if you are trying to get an accurate comparison, you should try and get at what figures would be on both sides of the balance sheet for the same year. It is true that it would operate the other way as well, but then adjustments would be necessary to get a fair comparison.—Yes. All I am pointing out is that the way it works depends entirely upon the ratio between the national paper income of the year in question and the national paper income of two years previously. If it is higher in the year in question then there is a tax reserve; if it is lower then the reverse is the effect and our scheme would produce a higher balance of tax in that year. If it is stationary, then it does not matter.

454. Are these all the corrections you want to make in your evidence?—Those are the only ones.

455. So far as the rebates are concerned, I have not got the facts which I should like to have; some of my colleagues may have them and so I shall leave them to deal with that in due course, but for the moment I would like to ask you a question on your opening statement at Question 375 of your earlier evidence. It is quite true that neither in your scheme nor in the recent modification of Lady Rhys Williams' scheme do you contemplate complete amalgamation of the benefits of the new social service scheme with the allowances under the Income Tax Act, but surely that means, does it not, that one at any rate of the attractions of Lady Rhys Williams' scheme has gone, because as soon as you cease to amalgamate them completely you reduce the saving that can be made on the cost of administration. If you have to keep two separate schemes going, it gets rid of the great attraction of Lady Rhys Williams' original scheme, from the administrative point of view, does it not?—It gets rid of some of it but only the smaller part. The big administrative costs are in the collection of the contributions with regard to which, incidentally, I omitted to point out that a staff of inspectors has to be maintained to make sure that the employers stamp the cards; that is another instance of something which would go.

456. I am coming to the details of the question of staff, so far as I can, later on.—It is quite true you have to maintain some, although a relatively very small part, of the present cost of distribution of benefits.

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457. While we are on that subject, we know that the Board of Inland Revenue estimate that there may be a saving of 10,000-15,000 in the staff of the Board of Inland Revenue which is, roughly, one-third to one-fourth of the staff which is employed purely on income tax work in the Board.—I did not know that.

458. I will get the exact figures when Mr. Cockfield is in the box. On the other hand, there is bound to be, is there not, a very substantial increase in the number of persons employed in the Ministry of National Insurance?—Oh no, a very substantial decrease, an enormous decrease.

459. I am bound to put that to you because my instructions are, if I may so put it following your phrase, that the Ministry of National Insurance visualise that, to carry out your scheme, would involve an increase in their staff larger than the saving to the Board of Inland Revenue.—I am quite sure that must be based upon a misapprehension of what they would have to do under our scheme.

460. Of course, they would have to issue all the books of coupons because, even if they are going to be collected through the employers, there must be a record. They would have to issue 50.5 million books of coupons to enable the 50.5 million inhabitants of this country to collect their benefits.—I have had the advantage of seeing Lady Rhys Williams' second memorandum and, without commenting upon her various modified schemes, I would like to say I emphatically agree, with the main part at least, of her proposals for the administration of the system and particularly with the suggestion that these books of coupons should be issued by the Ministry of Food at the same time as the ration books, with the ration books; this would mean no or very little addition to their work and would enable you to do without the Ministry of National Insurance altogether.

461. That I will put to the Ministry representatives when we hear them. I only put to you such information as I have. Of course, it will be found to mean, even in the Board of Inland Revenue, that they will have to secure a number of income tax returns vastly in excess of anything they have to deal with at present.—Income Tax returns?

462. Yes, because every penny of income anyone in this country makes will be taxable under your scheme, nobody will get off.—But all by deduction.

463. So that, Savings Bank account interest, instead of being paid as it is at the present time, would have to be paid by a deduction. There will be no £130 limit at all, of course. It is true it can all be done by deduction, but returns will be necessary, surely, in order to see whether the income gets over the £600 limit and attracts the extra tax?—In so far as it was earnings, it would be deductible and it would simply be deducted by the employers. No doubt they would have to devise some means of checking up on the question whether unearned income was going to put people near the £600 limit, but that would be all they would have to do and I think in their own memorandum they suggest that could be done by a series of test checks and not by calling for returns from everybody.

464. I have no doubt it could be done in that way, but a very much larger number of test checks would be necessary than when the crucial limit is, as it is at present, £2,000 and not £600.—But at the present time they have to get information from every single person in order to make up his code number and also, I think I am right in saying although I have no experience of it, they have to get a return in order to decide whether he comes within the full rate or one of the reduced rates.

465. They can probably tell that fairly well and it would only be a question of test checks if they got near the borderline, I suppose?—Possibly that is how they would do it, but they would get rid of an enormous number of returns.

466. The next question I wanted to ask you was this. You say that one of the merits of your scheme is that you get rid of the means test. I am not clear how it happens because even under your scheme may there not still be claims which will have to be and should be considered for extra help, in cases, for instance, of higher rents than the average rent and so on? I should not have thought

your scheme completely abolished the means test and if you say it does I should like to know how it does it?—As far as pensions are concerned, it does it completely. Regarding other benefits we have not dealt with the question whether they ought to be increased all round to meet the cost of living changes; with the present movement in the cost of living a very large part of the administration is being thrown upon the National Assistance Board and we have not made any proposals which would alter that. I observed that Lady Rhys Williams in her revised scheme went into it but we did not think it part of our particular business to go into that.

467. When you said in your evidence that you got rid of the means test, having previously said that your scheme enables the pensioner to work without having to bring what he earned into his pension, I thought you were dealing with two different things, but apparently now you are really dealing only with one and the same thing, namely, that the pensioner should not have to account, so to speak, for anything he earned in order to draw his pension. Is that the whole point?—Yes, I think that is the main point. I do not think there is any other point at which the means test applies at present, is there?

468. Not as regards pensioners.—Of course, if one could get rid of the necessity for the National Assistance Board and deal with a large proportion of the cases—health insurance claims and so on—by supplementary benefit, so much the better, but we have not gone into that aspect of it.

469. I want now to refer to your statement at Question 377 of your earlier evidence. You are pointing out that getting rid of the income tax allowance by way of personal allowance removes the necessity of giving to the low paid wage earner special consideration as distinct from his fellows. May it not have been an act of deliberate policy to give larger benefits to those in receipt of higher incomes who, as a rule, keep their children longer at school and often pay for the education of their own children at public or grammar schools? Might that not have been one of the reasons for giving them a larger income tax allowance which benefits them rather than the low paid worker, while giving the family allowance to everybody including the low paid worker? It is not for us to decide whether it is right or wrong, but it seemed to me that it might have been a deliberate act of policy?—I would not like to express an opinion about that. We do feel that the present allowances in the case of the low paid worker are entirely inadequate and that what we have said here as to the effect of that on wage claims is absolutely correct. With regard to the other point, we have retained that larger allowance to the class to which you have referred to the extent of an allowance of some £75 in respect of each child from the supplementary tax, i.e. the tax over £600. As I pointed out when I was here last, we do not mind whether it is done in that way or whether it is done in the way suggested by Lady Rhys Williams or by the Royal Commission on population, which we rather thought was outside our remit, by having a higher child allowance for those who pay more income tax. In one way or another we have retained that.

470. The next question I want to put to you arises from a memorandum we have received from the Inland Revenue Staff Federation. They have been considering your scheme and they feel that it lacks clarity, that is to say it gives the Chancellor of the Exchequer when he is considering his Budget less means of redressing inequalities. I will read to you what they say and I should like to have your comment on it.

"Although in theory benefits could be manipulated like tax allowances, it would not be very long before any reduction in them would arouse the same kind of emotional feeling as those which would be engendered today by a proposal to decrease unemployment pay or to reduce old age pensions. People would acquire a vested interest in their social security. This means that the only way of altering the tax burden would be by altering the standard rate. Under the present system, an alteration in the standard rate is only one of a large series of devices or combinations of devices open to a Chancellor of the Exchequer. He can so manipulate the allowances as to modify or increase the tax burden upon particular economic and social groups. He can diminish

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in particular cases the effect of what would otherwise be a general decrease. Under the Liberal scheme, much more personal income would be taxed than at present so that an alteration in the standard rate of even one penny would have important consequences."

I did give you the illustration of what I'd. would do,

"and there would be no machinery for adjusting the shoe where it pinched in any particular case."

I would like to hear what you have to say about that criticism of the scheme; I am not saying whether it is right or wrong.—It is true that we desire to avoid complications as far as possible and therefore our scheme would discourage manipulation by the introduction of fresh complications which is what really happens year by year in the Budgets of today, but you can under our scheme make alterations both in the rate of tax and in the rate of personal cash allowances. One advantage of that is this possibility. If a period of depression were to come upon us, one of the most effective methods of dealing with it would be by a temporary manipulation of the cash allowances because I think it seems to be more or less generally agreed now by economists that the way or one way to avoid depression is to put more spending power in the hands of the public and less in the hands of the State and this is the easiest possible way of doing that.

471. You have found a subject upon which economists are unanimous, have you?—No, I said "almost". At the end of our supplementary memorandum, Mr. Peacock has pointed out that even a small alteration in the standard rate of tax would affect the incomes of millions of taxpayers.

472. That is exactly what the Inland Revenue people would say.—We think that is a good thing. Apparently they think it is a bad thing.

473. At any rate, you really agree with their criticism, that it does reduce the possibility of doing that, your scheme is less elastic and it does deprive the Chancellor of the Exchequer of some means which he at present has of rectifying particular conditions if suddenly he thinks it desirable to do so, because there are no allowances, so to speak, for him to juggle with?—We agree it has that effect, but we do not regard that as a criticism.

474. There is one thing which is probably in your scheme but when I was re-reading it last night I could not find it, i.e. how you deal with the question of adult dependants. At the present time, as you know, income tax allowances are not confined to wives and children but apply to adult dependants, too.—Everybody gets the 10s. and it applies equally to the adult dependant.

475. But the adult dependant will get it whereas the person who is keeping the adult dependant will not—But it goes into the family just as the children's allowance does.

476. But whereas at the present moment the keeper of the adult dependant gets the allowance, you have transferred it, whether you increase it or reduce it, from the keeper of the adult dependant, so to speak, to the dependant himself. Is that the answer?—It makes the adult dependant so much the less dependent and if he or she does not need it over the keeping will stop.

477. That covers, I think, the rather desultory points that occurred to me on re-reading your evidence. I will now ask Mr. Crick, who has some questions to ask you particularly directed to the National Insurance Fund, to commence the questioning by the other members of the Commission.

478. Mr. Crick: I wanted to explore your collective mind, if I might, on matters that fall within Section III of your supplementary memorandum, "The Abolition of the Contributory System". It appears to me that in this supplementary paper that set of recommendations has become an integral part of your whole plan. That is so, is it?—I think so. I am afraid I have not given close study to that part of the supplementary paper myself, it was written by Mr. Peacock; but I will do my best to answer your questions.

479. If you would, I would be very grateful. One of your reasons for proposing the abolition of the contributory system is that you feel, as you said towards the end of your statement at Question 375, that the insurance system is misleading and that in the past at least entirely excessive and unnecessary reserves have been built up

because the system is based upon an assumption, which on the pre-war facts could be well justified no doubt but has turned out to be quite unjustified on the post-war facts, i.e. 8½ per cent. unemployment; it has not happened. Does that imply that you feel that unemployment is never again going to be very much higher than it has been in the past five years?—I would not like to make any prophesies about that. We hear a great deal about "Full Employment" policies having something to do with preserving that and I think they may. I would not like to put it higher than that.

480. Then you would also agree that a very large part of the reserve fund has been built up in anticipation of very heavy pending pension liabilities which are subject to actuarial estimate, quite apart from unemployment?—Yes. I observe that some of it is now being paid out under that head or about to be paid out under that head.

481. Do you see no advantage whatsoever in trying, if I may put it so, to equalise the financial burden both in respect of foreseeable pension liabilities and in respect of conjectural unemployment liabilities over a long term of years?—When it is really all part of the national taxation system, I doubt it very much. At all events, there is this large reserve that has been built up and we do not propose to touch it.

482. I am coming to that. I suggest that you are making some very definite proposals about touching it, but my point at the moment is that you see no advantage in trying to equalise the financial burden over a long term of years and, therefore, you are perfectly willing to put all those demands straight upon the Budget from year to year?—Subject to the fact that there is already a large reserve fund which in effect is treated as part of the Budget, I would say "yes" to that question.

483. Would you not feel that, if you got into a time of depression or financial stringency, there was a greater risk of a cut in benefits if those benefits were chargeable directly upon the Budget than if those benefits were paid in part out of a fund accumulated in past years?—Yes, I think there is some substance in that and we have no objection to the retention, as I see Lady Rhys Williams now proposes in her revised scheme, of some contribution in years of prosperity, but we think the reserve fund has been built up to an excessive amount and furthermore that, unlike other insurance surpluses, the beneficiaries have no direct claim to any specific benefit from it. In the old Health Insurance Service there was a definite system of valuation by which the members of the Societies which had built up surpluses got the benefit of them. That has gone altogether now. If anybody gets the benefit of them it is purely by Ministerial decision and not as of right.

484. May I take you to a slightly different but related point. I gather from what appears in the concluding paragraphs of Section III of your supplementary document, you have no quibbles at all about abandoning the flexibility provisions with regard to contributions under the National Insurance Act, 1946. I wanted to ask you whether your position there rests upon your view that that particular flexibility has no value from the point of view of stabilisation, or that there are other means which are much more effective and much more stable under your scheme?—Once you tell me the man the truth, namely, that what he is paying by way of contribution is only part of what he is really paying for the social security system and you earmark a portion of his taxation as representing the whole of what he is paying to the social security system, then you have got your flexibility in the tax and you do not need special contribution flexibility provisions.

485. You would prefer to rely purely upon flexibility in the tax rates?—Yes, as long as you tell him the truth as to where his tax is going, which it is easy to do under our scheme. It is not easy at all and in fact it is misleading under the existing scheme.

486. Now that brings me up against a practical problem which arises from constitutional procedure in which you are very much more expert than I am and you can guide me on this. Is it not true to say that the flexibility provided for under the National Insurance Act, 1946, is very much more readily availed of than any possibilities of flexibility in the tax system—of variations, that is to say, in the rates of annual tax?—I should not have thought so. It seems to me that we have had Chancellors recently who have had the courage to say that they are deliberately budgeting for a surplus for anti-inflationary reasons. I

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think that is the proper course at the proper time, and they would no doubt say at some other time when a period of depression came upon us that they were deliberately budgeting for a deficit in order to combat the depression which may also be a sound view. It seems to me to be just as flexible, but the point is you have your flexibility in an element in which ability to pay is the predominant point instead of having it now under the National Insurance Act, 1946, in a poll tax where you have to impose the same flat rate on everybody though you may vary the flat rate I think for the lower paid worker. If it were really done, if the rate of contribution were really raised under this section, which I do not gather it has been yet, it would press very heavily, being a poll tax, on the lower paid worker.

487. That I appreciate, but on the mere matter of mechanics, the examples you gave about certain rates of tax at such a point as will yield a disinflationary surplus, that kind of example occurs once per annum in the ordinary course at a regular time of the year, whereas the national rates of contributions can be changed at any time of the year.—Have they been?

488. They have not, but the flexibility is greater, I suggest, than in the long drawn out and cumbersome procedure of altering annual rates of tax.—There could always be a supplementary budget, when indications of any immediate emergency arise, but apart from that I think it has not been used, whereas the fact that it has been used in the building up of an anti-inflationary surplus, points to the fact that it is already, even with the present complications of income tax, easier to do it that way than by raising the contributions.

489. Would you not feel it is obstructive to the normal processes of working and business life to have frequent fluctuations in tax rates?—If we got one downwards, I do not think we should worry.

490. You do want to know where you stand for a length of time.—Unfortunately it does not happen. I think one must expect fluctuations yearly.

491. May I come back to this very vexed question of the National Insurance Reserve Fund. Despite what you said a few minutes ago it is very clearly stated in this paper that you envisage the application of those funds to the cancellation of Government debt. In fact it is put so blandly . . . —Is the original?

492. No, in your supplementary memorandum towards the end of Section III. It is put so blandly that it almost had a faint tinge of immorality about it when I read it last night. You say that you take account of a saving of £33 millions per annum of national debt interest in your calculations and then in Section III you state quite explicitly all that happens is the Government cancels the debt held against itself. You appreciate these reserves are not the property of the Government?—I find it very difficult to see any practical content in that statement under present conditions. Under the old Insurance Act that was really true. They were really the property of the Approved Societies and the Approved Societies could apply their surplus to the benefit of their particular members. Under the present insurance system it is the Government.

493. You would agree that those reserves have been built up in part, as indeed you show in the table in Section III (b), by the contributions of employers and employees?—Yes.

494. Then you would agree also in some sense at least that the assets are the property of the ultimate beneficiaries under the insurance system including the future pensioners?—Those contributions today are merely a kind of tax and the distribution of the reserves is entirely at the discretion of the Government. I noticed in the paper, since I was here before, it is proposed to make certain increases and it is said that is rendered possible by drawing upon these reserves, but really to my mind the whole thing has ceased to be separate from the Government and is just part of Government today.

495. You agree legislation would be required to carry out this application of the fund to the reduction of debt?—I have not looked into that; you may be right, I dare say. Personally as I said I rather wish these questions could have been put to Mr. Peacock, it is his memorandum. I am not sure that I personally would like to

commit myself to what he said there that the reserve fund should be got rid of. I do not know. It is no part of the essence of our scheme. It might be wise to reduce the national debt to that extent, I am not sure.

496. Now I asked Lady Rhys Williams some questions which led me to believe, and I think the evidence confirms my impression, that she would savings what one might call a dual budget, that is to say, she would have a separate social budget covering the expenditure on nearly all the social services and that would be financed out of her flat rate tax and the rate of that tax would be fixed by reference to the expenditure on that social budget alone. Now am I right in inferring that there is no such suggestion in the Liberal Party Scheme, that you do not advocate a separate social budget?—We have not gone into that. I do certainly advocate personally bringing together all, what I may call social security expenditure and making it quite plain on any document which is presented by way of demand or receipt or explanation of any kind to the payer just how much of what he is paying is going towards the social security. I do not quite see why that should involve a separate budget and our figures of course, the particular social security items which we are dealing with, do not exhaust the proceeds of the income tax. There remains the contribution towards general expenses. It is quite true there are a number of other items which are really social security expenditure which we have not brought in: it may be if you brought those in, education for instance, as I see Lady Rhys Williams does, and housing subsidies for which certainly there would be a strong case, it might be it would exhaust them all. I have not gone into that.

497. You might like to consider that at some future time. There is one question I should like to ask arising out of some very interesting remarks you made last time on the incentive and disincentive effects of tax. You will remember the passage very well?—Yes.

498. I think I am right in saying the whole of the discussion on that matter related to what one might call the wage earner, or at any rate, people in the lower income groups?—I think I made it clear some of my remarks applied, *mutatis mutandis*, to those in the higher income groups.

499. Did you?—I certainly intended them to. In detail I was dealing with those in the lower groups.

500. What I wanted to ask you was this: does your scheme do anything to weaken disincentives at the higher income levels, particularly in what we call the surtax levels?—We treated surtax as outside our terms of reference and did not go into it at all, therefore the answer is in the main, no, except so far as the income tax, and what we have called the supplementary income tax, applied to those people as well as to others. Of course as a matter of administration it would be very desirable to link up that supplementary tax with the present surtax so that you do not have three systems but only two, but there again that is a matter of administrative detail which we did not go into.

501. You would not claim any virtue in your scheme by reason of disincentives at the higher income level?—I do not think so, not seriously.

502. There is one very small matter finally which I wanted to follow up arising out of some answers you gave to the Chairman a few minutes ago when the discussion was turning on the cost of collection under your proposed scheme.—Yes.

503. As I understood it you made the statement that the problem of getting down to the lower incomes which at present do not attract the attention of the tax collector at all would be met mainly by deduction?—Yes.

504. That of course one can see in connection with employed persons, but it does not meet the case, does it, of the very large number of self-employed and people of independent means with very small incomes. For example, the enormous number of small traders who at present the Inland Revenue will ignore but who under your scheme will come under the hurdle for the purpose of collection?—That is true. When you say independent means, yes, that would be done by deduction as now.

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505. So far as investment income is concerned?—All investment income; but there would be a certain amount of assessment of small people who are self-employed and who now escape. Presumably the Inland Revenue today has to make a check from time to time to see whether they are coming over the limit or not. I do not quite know how they do that but that is relatively a minor matter. I see Lady Rhys Williams made a suggestion they should take a spot figure and see whether the taxpayer objected to it, which is a practice not uncommon at the present time.

506. That kind of procedure is a very expensive way of collecting a very small total tax, is it not?—Yes. It would be a matter of administrative consideration how far it is worth doing.

507. You would not suggest, would you, a definite exemption limit within your scheme?—I would not have any objection to it in those cases. It is purely a question of how far administratively the game is worth the candle.

508. Mr. Woodcock: Only one or two questions. You were going over your previous evidence and coming on to this question of the absenteeism which you said occurred in March.—Yes.

509. Was that merely an assertion, or have you evidence of it?—It was on information received, but I do not think I must disclose the source of my information.

510. If I said we have information that points in the other direction, in fact there is no more absenteeism in that period than at any other time, or in so far as there is absenteeism in that time it is by people who have no repayments to come, what would you say to that?—I can only put it against the information I have received. I cannot give any direct evidence one way or the other about it.

511. You then went over the statement you made on the last occasion where you said the Inland Revenue had been unfair in commenting on your figures in saying you would not take into account tax collected after the year in which it was due?—Yes.

512. I understood you to say whilst there may be something in that, that criticism is valid only in so far as we are in a period of inflation and if, as it were, prices were stable there would be nothing in it and that if there were a period of deflation there would be a net gain?—Yes.

513. But merely the Inland Revenue were taking your figures?—Yes.

514. You took the figures for that year.—I agree they are right for that year, although I was partially right in what I said that it would catch itself up because by taking the year 1950 the deficit is enormously less, it is only £74 millions instead of £214 millions, but that is purely because it so happens that the increase in the national paper income as between 1950 and 1948 was not so great as it was between 1948 and 1946.

515. That may affect the figures you were putting, but surely you put forward figures to show what you would be required to spend in a year and what you can receive by way of income in that year?—And in so far as we chose the year 1948 the criticism was perfectly sound and applicable to 1948.

516. That must be so in regard to every year?—In some years it would work the other way, that is the point. It happens that 1948 was a year in which it worked that way and worked very largely that way. 1950 was a year in which it worked that way but not nearly so much. We may come to a year when it works the other way.

517. We are at loggerheads somewhere. You give a set of figures for the year. Why does deflation, inflation or stability come into the consideration of the income of a year and the liability of a year?—It does not come into the income or the liability of that particular year, but that particular year was only chosen as an illustration because you must take some year to get actual figures as an illustration of the operation of the thing over a period of years, and I say that the criticism is perfectly well founded as applied to that year; but if you look at it over a period of years there is not likely to be very much in it which is evidenced by now taking the year 1950 since we have got past the year 1950.

518. Yes. Now regarding another aspect of flexibility, the aspect raised by the Inland Revenue Staff Federation in their memorandum. As I understand your scheme up to a certain income limit you will have one rate of tax in place of the present position where you have no tax, tax at 3s. 6d., tax at 5s. 6d. and possibly even tax at 9s. 6d. though it may not go as high as that: so there is bound to be less flexibility in your scheme from that point of view where you have one flat rate?—You may say that involves less flexibility, but it is merely because what enables us to do away with these changes in rate is that we pay the allowances direct instead of taking them from the tax assessments.

519. I am speaking of the rate of tax, we will come to allowances later.—It is because of that that we have a flat rate of tax, whereas when you do it the other way you cannot have a flat rate of tax. It would be unfair.

520. I understand that. On the other side the allowances are the same for everyone in the country except that you have special allowances for old people, sick and unemployed?—Yes, supplementary.

521. If at some time the Chancellor of the Exchequer wished to make some adjustments he is in this position, he cannot make an adjustment in the allowances for people who are poor without making the same adjustments for people who are rich?—Yes, that is perfectly true but then our scheme produces such immensely more advantageous results for people who are poor than any scheme adopted that they would not have a grievance about it.

522. I wanted your agreement that that is what happens.—And it is possible to adjust the supplementary rate without adjusting the minimum rate.

523. Yes. But as the Chairman said if we have criticisms do not think we are partisan.—Quite. I am not speaking in any hostile sense, but it is not quite correct to say you must adjust in that way. You can adjust the supplementary rate and also as I pointed out last time I think, we have perhaps made an excessive concession to the unearned income people in taking the rate of 6s. and 5s. I think that is exemplified if you look at our table in schedule II which produces in the last column rather more increases, except at the lowest incomes, in the unearned income payer than in the earned income payer. In so far as it may be necessary to raise extra money to balance our scheme that is certainly one of the ways in which I would do it, and I am not certain whether on reflection I would not do that anyway.

524. When you say supplementary rate, do you mean rate of tax or rate of allowance?—Well, both, but chiefly the rate of tax.

525. The other would be through public assistance?—I beg your pardon. I did not understand. I thought you meant the allowances for children in the supplementary tax: no, I think you can vary both the standard rate of tax and the standard rate of allowances in either direction as circumstances warrant.

526. But it is not as easy to do, it is not as easy for a Chancellor to reduce a rate which is applicable to everybody in the country whatever their circumstances, either to increase or decrease that rate, as it is when you have people separated out.—That is a matter of opinion. It may be easier, but on the other hand it is more complicated.

527. The same with the tax up to the limit of 5s.; the Chancellor in considering whether to raise the rate which you put at 5s. to 6s. or 5s. 6d. or any sum, has to consider the effect not only on the man with £600 but on the man with £100 or even £10 under your scheme?—Yes, that is perfectly true. I think on the whole that is an advantage, but it is true all the same. He can vary the relation between the tax and the allowance and of course that in itself has the effect of assisting the people at the lower end or can be made to if he so wishes.

528. Sir Harry Giff: The present rate of income tax that you suggest in your scheme is based on present day costs of the social services?—Well, of 1950, that is in fact it does not take into account the recent changes in this year's budget or the still further proposed changes in the social service rates.

529. In regard to the balance that is in the fund at the moment, I think in answer to Mr. Clegg or in your document you said you feel those balances should be taken over

18 July, 1951]

SIR ARTHUR COMBES CARR, K.C., MR. ALAN FRADOCK, D.S.C., M.C.,
 MRS. GUY NAYLOR AND MISS NANCY SREAR

[Continued]

by the Government?—I really do not think there is a terrible deal of distinction in it myself today. There was in the days of the Approved Societies but to day there is so little between the insurance fund and the Government I do not think it much matters. I am not however committed myself to the proposition that they should sell out or caput the balance in that particular fund. There may be an advantage in keeping a reserve fund.

530. In the event of there being a great change in the unemployment figure in the future, that would call for a greater expenditure from the Exchequer?—Yes.

531. How under your scheme would that be met?—It will have to be met out of the budget. It would probably be accompanied by less expenditure in other directions but it would have to come one way or another out of the budget just as it does now when any reserve fund which is retained is exhausted.

532. Having started off with a scheme that nearly approximates to balancing, is it your intention that anything that comes along to alter those figures either in an upward or a downward direction should be met from the Exchequer; that your 5s. rate is a fixed rate for all time irrespective of how increases in benefits might take place?—No, the 5s. rate includes something more than cost of social security benefits. It includes a contribution shown in the tables to the general expenses of Government and therefore it might have to go up if the general expenses of Government increase or go down if the general expenses of Government were reduced.

533. But if the increased cost was brought about by unemployment, do you think it would be fair for it to go up if you had taken the balance which at present exists in this insurance fund?—As I say I am not personally committed to the view that you should take the balance which at present exists in this insurance fund. I think that should remain. Whether it is worth while, I am not quite sure, I rather wish somebody had put this question to Mr. Peacock because I do not understand why he put that paragraph in. He may merely have meant there is no particular point in keeping that fund in the form of Government securities when they simply pay the interest out of one pocket into the other, but I think there is something to be said for keeping a reserve fund in whatever form it is.

534. We might hear something more from you on that particular matter because it is part of your scheme as I understand it.—I do not think it is part of our scheme to abolish that reserve fund at all.

535. There is just one other point concerning the question of absenteeism and Income Tax relates under P.A.Y.E. In reply to a question by Mr. Woodcock in regard to absenteeism in the month of March, Sir Arthur replied that was the fact according to his information. What I wanted to ask him was whether he knows there are figures issued as to absenteeism covering every month of the year in the mining industry?—Yes, I have at some past time seen some figures I think.

536. I was going to ask him if he would refer to those figures because according to my information the month of March is a much better month from the standpoint of absenteeism than either January or February and many other months?—I will accept that from you. Then I was misinformed at all events to the extent of March.

537. Chairman: September is bad in the Yorkshire collieries for quite a different reason.

538. Sir Harry Gill: Therefore as it affects the rebate question, . . .—It was wrong to pick out March as a particularly important month, but I still, with respect, think the rebate system is a temptation. I do not say many people, obviously everybody does not fall for it, but it is one of the things which goes to account for absenteeism in general.

539. Mr. Kenrick: I have one very small point. I understood you to say this morning you visualised using the medium of the rating book for distributing the necessary cards or books?—Yes, I think it is very possible Lady Rhyll Williams is right, that would be the most convenient way of doing it, but one wants to know how much longer rationing is going to last. There must be some-

body to distribute books as there must be somebody to distribute family allowance books now. Whether it would be an administrative advantage as she thinks to link it with the distribution of ration books I am not sure, but it strikes me as a good idea.

540. It occurred to me if you were founding a new system on a Ministry which may not be with us for ever, it was not an ideal basis?—There is that disadvantage, I agree.

541. Mr. Hicks: I wonder if I might raise a rather large point at this late stage of our discussion. I have been trying to think what use we can get out of these discussions for the benefit of our future deliberations and it seems to me, I should like to know if I am right about this, that we ought not to bother ourselves too much about the details of the plans which you have put forward. It is in fact made fairly clear in some of the things you have said that a good deal is to be regarded as rather illustrative; that in fact you are offering for our consideration really a series of principles rather than a cut and dried scheme, it being fairly clear the information out of which a really finished scheme can be produced was hardly at your disposal?—A great deal of it is not made public and it is very difficult for anybody, especially with the limited resources we have, to gather together even all the information that is made public, let alone what is not.

542. I was trying to think out in consequence what really are the principles in your scheme in order of importance, and it seemed to me that it would be very useful for us if we could try and make up our minds what those principles are. It seemed to me the first principle is really—that the whole thing stands or falls by—the replacement of the fixed lump sum social insurance contributions by what I will for the moment call, because I want to take one step at a time, a social insurance contribution proportionate to income. That would be the first step?—Yes.

543. That seems to be a very vital step indeed, and one that could conceivably be taken independently of everything else and obviously has a lot to be said for it. By itself it probably costs money administratively as it means looking into a lot of people's incomes you do not have to look into now, and that is more expensive than the cards you use. On the other hand it raises no question about the status of insurance funds or about a very large number of the things which have been discussed. There is however one difficulty at that stage which comes up as soon as we begin to discuss it in terms of principles, but it does not come up when you put forward figures. That is, supposing it was to be necessary for the time being to have a rate of 3s. in the £ as the social insurance contribution, then if for any of the reasons discussed, either because of the desirability of increasing the rate of social insurance services or for anti-inflationary reasons it became desirable to raise the rate from 3s. to 3s. 6d. let us say, you would run a great danger of upsetting your whole income tax system by so doing. It would mean you would run into all your trouble about surtax going up to 20s. in the £ and so on; and for that reason, in order not to upset the income tax system and to keep the social insurance principle as well as you could, I would like to suggest it would be desirable to allow the social insurance contribution as a cost for any other income tax that was imposed. I do not think that there would be any fundamental difficulty about that. You can get over the difficulty in that way.

544. Chairman: It is deducted at the moment.

545. Mr. Hicks: And so it would not be unreasonable if the tax were on a proportional basis. That kind of change does not involve any of the difficulties about social insurance funds and so on. But through that point you can go onwards and consider what consequential changes which might be desirable in themselves were more practicable on the basis of the proportional contribution than they are on the basis of the flat sum contribution. The changes of allowances and exemptions as at present given can be replaced by changes in benefit payments, so that consequential adjustments then become possible. You can go essentially as far as you like, as far as you thought the balance of advantages took you.—As far as I follow what is passing through your mind I would agree. I do want to make

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MR. ARTHUR CONYNS CARR, K.C., MR. ALAN FRASER, D.S.C., M.C.,
MRS. GUY NAYLOR AND MISS NANCY SEAR.

[Continued]

it clear that this question of doing away with the reserve fund is merely an exercise. It is not in the least a necessary part of the scheme and I personally see no objection not only to retaining the existing reserve fund, but to adding to it in times of high income such as the present. That is purely a matter of the rate you choose to adopt. In regard to the principles behind the scheme, certainly one of them is to substitute the ability to pay for the poll tax in social insurance contributions. Another of course is to deal really adequately with what is only nibbled at by the existing family allowances, the question of family provision, and to deal with it for the lower paid man on the same basis as that on which it is already dealt with through income tax allowances for the higher paid man. That is the second big question of principle in our proposals. The third of course is merely simplification to which we attach a great deal of importance. We think having all these things done by so many different systems and the complication involved is extremely wasteful both in the Civil Service and in industry and really undesirable. Complication in itself we consider a thing undesirable. If I might add this generally in regard to the questions that have been put to us this morning, I hope in looking at our supplementary memorandum the Commission will not overlook the note to Section IIa, that is to say, the question in our proposal of refusing to grant old age pensions on the same terms to husband and wife is by no means the only method we have in hand for dealing with any possible deficit. There are several points, one of which I drew attention to the other day—the income tax on old age pensioners' earnings and others to which Mr. Pencock draws attention in his Note 4 to Table I and indeed in the original notes for which no credit is taken in our table. We think the pensioners' income tax, if our proposals really produced the results we are aiming at, will be quite a big figure and there is the question of retention in some form or other of the employer's contribution. All of those would easily cover any points of deficit made here, and there is the further point which I made just now to you, a greater differentiation in the rate of tax between earned and unearned income which I think is justified by the fact that our tables do show, and I think undesirably show, a greater benefit at many ranges to the unearned income than to the earned income. I think perhaps that should be equalised, but we hope the Commission will consider it on the broad methods of principle and any deficiencies in our ability to investigate detailed figures will be made up. If that should result in any further substantial criticism of our proposals we should be very glad to have an opportunity of submitting a further memorandum.

546. *Mr. Kildor*: If I may at this rather late hour ask a few questions about the incentives because I feel it is really one of the more important aspects of this whole plan. So far very little has been said about them today. The main feature of the Liberal plan or of Lady Rhys Williams' plan is to give a universal cash allowance and to charge a flat rate of tax on every unit of income. I leave out the question of administrative simplicity, I am not concerned with that. We ought to consider what is the effect of these two major changes on incentives generally. If you now look at the flat rate of tax of 5s. a week, would that in itself be an incentive or would it hinder it? Would you say the fact that it is a flat rate and not a rising tax as at present would be a good thing from the incentive point of view? The vast majority of people in this country, the majority of workers do not at present pay even 5s. marginal tax, not if you take into account earned income allowances.—No.

547. You would not say therefore for all those people who at present do not come into the marginal category of more than 5s. there would be any gain of incentive, in fact there may be less. It would come to those people as a reduction of 25 per cent. of any earnings, in fact the same thing as if the wages had been reduced from the point of view of incentive to work. I am not saying whether it is substantial or not, but I do not see any benefit to incentive here?—I do not say at that point there is any benefit. I do not think either that there is a disadvantage. I gave my views to you last time. It is a psychological question really more than anything else and it is therefore more difficult to be precise or dogmatic about it than on any other type of question, the question of the effect it has on people's mind.

548. If you claim, as you do claim, that there is an increase from the incentive point of view, that this scheme is an improvement, it would really only be so to those people who at present pay a higher marginal rate than they would pay under your scheme?—I think Mrs. Naylor would like to say something if permitted to do so. *Mrs. Naylor*: I should have thought that was not necessarily so. People vary in their reactions to tax in the same way that others vary in their reaction to the rate of interest. Some people save more at a low rate of interest because they want a given income from their earnings. Equally some people are prepared to earn more if they have to be taxed more because they want an income for their necessary commitments.

549. I do not think that is relevant here. You give back the income in the shape of cash allowances. Supposing a person just balances out. He does not pay any tax now under the present system and equally would be let off under your system, but being let off is the result of two opposite changes, 25 per cent. reduction in earnings plus 12s. 6d. or 10s. a week cash allowance. I should have thought in those circumstances people would work less in so far as they are affected by incentives at all. You may say incentives do not matter. In that case the objections to paying the rate may also disappear, but in so far as incentives matter at all the joint effect of those two changes would induce them to earn less money than before.—*Miss Sear*: I have been trying to get some information on this and I think all one can say of the question of incentives is you simply cannot generalise about it at all. What is an incentive to one person at one time of his life in one place is not an incentive to another, and it is unwise to say it is or it is not an incentive or disincentive. It will be an incentive to one person and a disincentive to another.

550. You realise it is equally destructive of your claim that this will improve the incentive?—*Mr. Arthur Conyns Carr*: The claim is based on the abolition of the rebate and the abolition of the jump in rates of tax. *Miss Sear*: I think it is only at that point you can claim it is an improvement in incentive, at the point at which you jump from one rate of tax to another.

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552. I should say one jump instead of two jumps.—There are jumps all the way through at present.

553. The other question I want to ask is about cash allowances. Would the payment of a universal cash allowance to everyone affect the willingness to work? I heard suggestions that it would affect it favourably. I should have thought the balance was rather the other way. There are a lot of people, married women for example, who might be less inclined to go to work under this scheme than they are now. Again you would have to admit you cannot say for certain anything one way or the other?—*Mr. Arthur Conyns Carr*: I am afraid I cannot throw any more light on it. It is so much a matter of the way in which it affects different minds, both those considering it, and more particularly, those actually working or not working. *Mrs. Naylor*: Originally this scheme, when Lady Rhys Williams produced it a number of years ago, was intended to provide an incentive because the weekly cash allowance was going to be the equivalent of the unemployment payment, therefore there would be an incentive for people to work rather than live on their unemployment money. To the extent that the weekly cash allowance has been so much reduced that aspect of the incentive has been very much modified, but it still exists to some extent. It exists in two ways. One, and paragraph 21 of the original Yellow Book refers to it, is this question of the stimulus to the unemployed man to work. The difference between the weekly cash allowance under our scheme and the total weekly unemployment pay is less than the present unemployment benefit, but the second thing is the effect it would have on the potentially productive person to work hard when he knows the slowcoach, is being taken out of, this current feeling that the speed of the slowest is the only gentlemanly speed, the feeling that he must not work a buddy out of a job, the knowledge that the buddy will have a small income each week, is one of the incentives to working harder. I agree to the extent that it has been cut down very much, that aspect of the incentive has been considerably reduced.

18 July, 1951]

SIR ARTHUR CONYNS CARR, K.C., MR. ALAN FRASCOCK, D.S.C., M.C.,
MRS. GUY NAYLOR AND MISS NANCY SEAR

[Continued]

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18 July, 1951]

Sir ARTHUR COMYNES CAIR, K.C., Mr. ALAN PEACOCK, D.S.C., M.C.,
 Mrs. GUY NAYLOR AND Miss NANCY SEDAR

[Continued]

554. I would suggest even under Lady Rhys Williams' original scheme there may have been an incentive to people who drew unemployment pay to work which does not exist now, but there are all sorts of people who may consider working or not working, such as married women, who do not receive unemployment pay?—For married women it would be a disincentive.

555. Finally, one last question. You say this is a simplification of tax and it is a unification to some extent of existing systems which is all very reasonable, but do you not think people in general would feel it was rather a revolutionary change, everybody being entitled to a flat cash payment merely by virtue of citizenship, so to speak, domicile or residence? I would have thought this was a very large change and would have large psychological effects?—Sir Arthur Comyns Cair: That does not frighten us.

556. It does not frighten you at all?—No.

557. One relatively small point, you suggested cash allowances were admirably suited to counteract inflationary and deflationary tendencies by varying their amount?—Either the cash allowance or the tax rate or a combination of the two.

558. I can see in times of depression and lower prices you can raise the cash allowances, but do you think it would be easy to reduce the cash allowances in times of rising prices?—I think it would be easier to operate by raising the cash allowance in times of lower prices and raising the rate of tax in times of rising prices.

The witnesses withdrew.

DOCUMENT HANDLED IN BY THE LIBERAL PARTY
 TO EXPLAIN THE CALCULATION OF ITEM 5 OF TABLE 1 IN THE LIBERAL PARTY SUPPLEMENTARY MEMORANDUM
 [See Question 423]

	£m.	Savings		£m.
Income Tax	1,420	1. Govt. Contribution to NI Funds 213-61	122	
Tax Reserves	108*	less		
Surplus on NI Funds	171	Expenses of Administration	26	
	1,699	Maternity benefits etc.	8	
		Injuries Benefit	14	
		Death Grant	2	
		Contribution to NISB.	41	
		2. Subsidies	317	
		3. Family Allowances	64	
		4. Non-contributory Pensions	25	
		5. Payments to Dependents under National Assistance	10 (est.)	
			538	

* Item 20h, Table 35; 5h, Table 9,
 Cmd. 8203.

£m1,699 less £m538 equals £m1,161

Mr. F. A. COCKFIELD and Mr. R. E. BRADY, on behalf of the Board of Inland Revenue, and Mr. G. M. WILLIAMS, C.B.E. and Mr. R. U. L. EDWARDS, on behalf of the Ministry of National Insurance; called and examined.

MEMORANDUM SUBMITTED BY THE BOARD OF INLAND REVENUE

The Liberal Party Scheme for the Reform of Income Tax and Social Security

1. The Liberal Party scheme represents the latest development of proposals originally put forward by Lady Rhys Williams, D.B.E., in 1942 in a booklet entitled "Something to Look Forward To". Similar schemes have been suggested by a number of other people, notably the economists Messrs. Haynes and Kirton, the "Economist" newspaper, Mr. S. P. Chambers, C.B., C.I.E. (formerly a member of the Board of Inland Revenue and now Finance Director of I.C.I.) and Professor James Meade, C.B. (one time Director of the Economic Section of the Cabinet Office and now Professor of Commerce at the London School of Economics). The present Paper is arranged in three parts:—

Part I consists of a summary of the various schemes.*

Part II consists of a general examination of the principles underlying them.

* At the time the memorandum of the Board of Inland Revenue was prepared the only scheme which had been submitted to the Commission was that of the Liberal Party. The Board's comments on the proposals of Lady Rhys Williams and Messrs. Haynes and Kirton relate not to the schemes later submitted by these witnesses (produced on pages 5 to 9 and 21 to 30 above), but to earlier published proposals.

559. Chairman: I have just two questions I want to put to you. First of all, as regards this question of the insurance fund balances, would it be true to say, do you think, the effect of retaining them would be, in the event of the bad times coming which Mr. Chick put to you, the Chancellor would feel bound to meet those bad times by, in effect, borrowing; in other words, using the balances he has in those funds, whereas if they had been merged as you suggest he would have to decide whether to find the money by borrowing or by taxation? That is, the retention of that fund would be the means of meeting the increase in unemployment payments?—That is so. Whether there is much benefit in having those reserve funds is a point I do not really feel competent to express a very strong opinion about one way or the other. I rather wanted, as far as we are concerned, to get the subject out of the way as one on which a decision is not essential to our scheme.

560. The last question I want to put to you is this, you said it was very important to tell the man the truth about what he was paying to social security, but if you are going to tell him the truth, the whole truth and nothing but the truth, you can only do that as regards the previous year. You can calculate what portion of every man's taxation went to social services last year, but you cannot make that calculation for the current year because until the year is out you will not know what your social security payments are going to cost, whether yours or the existing ones?—I think that must be true of any scheme.

Chairman: We are much obliged to you.

Part III consists of a detailed examination of the Liberal Party scheme.

Part I. Summary of the Various Schemes

Lady Rhys Williams' Scheme

2. Lady Rhys Williams' scheme first appeared in a booklet entitled "Something to Look Forward To" which was privately circulated in August, 1942. It was published, with considerable modifications, in book form in May, 1943.

The primary object of the scheme was to abolish what, in order to achieve this, Lady Rhys Williams proposed that the State should pay everyone sufficient for subsistence. She went on to suggest there would then be no need to make income tax personal allowances as the family responsibilities of the taxpayer would already have been taken into account by means of the social security payments. She proposed therefore that income tax should be charged at a flat rate on all income other than the social security payments.

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Williams sought to overcome this difficulty by providing that the taxpayer's own benefit should be given only against tax actually paid. This enabled her to reduce the flat rate to 7s. in the £, but it involved the reintroduction of national insurance benefits to cover the taxpayer in the event of sickness, unemployment or old age. By bringing back the national insurance benefits scheme, as modified, now failed to achieve the primary objective of amalgamating the two systems, it could claim little administrative advantage and the rate of 7s. was still much too high from the incentive point of view. The Haynes and Kirton scheme, with its rate of 8s. 4d. in the £ suffered from the same defect. The "Economist" newspaper started with the objective of improving incentive by charging a flat rate tax of about 5s. in the £ on all income and paying out the allowances in cash but only against tax actually paid. It went on to express the hope that it would be possible to develop the scheme to amalgamate income tax and social security. The "Economist" did not say how this could be done: certainly the scheme as actually presented could make no claim to achieve the amalgamation as the small amount of the cash allowances and their restriction to the amount of tax paid made supplementary social security payments essential in the event of unemployment, illness or old age. Nor could the scheme genuinely claim to improve incentive. For if the worker first had 5s. in the £ deducted from his wages and he then had the cash value (at 5s.) of his income tax allowances refunded to him by his employer, he would be left in much the same position as under the present system. What the worker is concerned about is the net pay he finds in his pay packet: he is not likely to concern himself unduly with the arithmetical processes underlying this result.

Mr. Chambers pitched his rate at 3s. in order to meet the incentive arguments. He proposed, however, giving no cash allowance for the taxpayer himself. The amount of the allowances proposed for dependants was not stated but they would have had to be small if the scheme was to be solvent. Supplementary social security payments would therefore have been essential and the scheme does not therefore achieve an amalgamation of the two systems.

Professor Meade's schemes are similar to the original Rhys Williams' scheme. The rates of tax assumed are as high as to be disincentive in their effects and the paying of the cash allowances—is an attempt to achieve solvency—gives rise to serious misgivings on the social security aspect.

The Liberal Party scheme which is developed from Lady Rhys Williams' scheme, postulates a rate of 5s. in the £ on incomes below £680 a year and cash allowances of 12s. 6d. a week each for adults and children; 2s. 6d. of this, however, represents "compensation" for the reduction of the food subsidies so that the true value of the allowances is 10s. only. The Liberal Party admit at once that supplementary social security payments would be necessary and thus they too fail to achieve the amalgamation of the two systems. Nor, for the reasons explained in paragraphs 35 to 38 below, can the proposed rate of 5s. claim any advantage, from the incentive point of view, over the present system.

23. The various stages of development through which these schemes have passed suggest, if nothing else, that the first two objectives set out in paragraph 22 above, namely, the amalgamation of income tax and social security and the improvement of incentive, are mutually inconsistent. If the scheme is satisfactory as social insurance the rate of tax required is so high as to be disincentive. If the rate of tax is kept down on incentive grounds, the benefits which can be given are too small to be effective as social security. No amount of arithmetical skill in constructing a scheme can provide any escape from this dilemma.

24. Administration. The third main objective these schemes set out to achieve was a saving in administration. This expectation was based on the assumption that with the amalgamation of income tax and social security the existing "duplication" would be swept away and a single Department would replace the Inland Revenue and the Ministry of National Insurance. Once it is admitted that supplementary social security payments would be

necessary the major economy anticipated disappears. Even with a modified scheme of the kind the Liberal Party propose, there would on balance be more not less work than at present in the Civil Service.

25. If the original objectives have thus proved to be unattainable, and what Professor Meade described as "an architectonic reform in this field" is only a mirage, can these schemes in general claim any particular merit either as social security or on taxation grounds? In their relation to social insurance, these schemes, in general, abandon the contributory principle in favour of taxation. This question was considered by Lord (then Sir William) Beveridge and in his Report on Social Insurance and Allied Services (Cmd. 6404) he says that the suggestion that the contributory principle should be abandoned in favour of taxation was not advocated by the great majority of the organisations and persons who gave evidence and involves a departure from existing practice for which there is neither need nor justification and which conflicts with the wishes and feelings of the British democracy. In paragraph 274 of the Report, he goes on to comment that:—

"The contributory principle was emphasised or accepted by all the organisations most widely representative of insured persons in Britain—notably the National Conference of Friendly Societies and the Trades Union Congress General Council. It is maintained as a central feature of the Plan for Social Security on grounds according with this expression of views. These grounds may be summarised under three heads:—

(i) The insured persons themselves can pay and like to pay, and would rather pay than not do so. It is felt and rightly felt that contribution irrespective of means is the strongest ground for repudiating a means test.

(ii) It is desirable to keep the Social Insurance Fund self-contained with defined responsibilities and defined sources of income. The citizens as insured persons should realise that they cannot get more than certain benefits for certain contributions, should have a motive to support measures for economic administration, should not be taught to regard the State as the dispenser of gifts for which no one needs to pay.

(iii) To require contribution on an insurance document for each individual has administrative convenience, particularly for a scheme which, while it covers all citizens, takes account of their different ways of livelihood, and classifies them, giving different benefits according to their needs. Contribution provides automatically the record by which the insured person's claim to be qualified for any particular benefit can be tested."

26. So far as income tax is concerned we can dismiss at once the various Rhys Williams' schemes, the Haynes and Kirton scheme and the Meade schemes. They all impose rates of tax far in excess of those chargeable under the existing law on the lower incomes and their effect on incentive would be disastrous. This leaves the Economist scheme, the Chambers scheme and the Liberal Party scheme. The last of these is considered in detail in Part III of this Note. The objection on income tax grounds to the other two is simply that they perform in two operations what under the existing law is done in one: the worker queues up at one pay-window to get his pay less 3s. or 5s. in the £ and he then queues up at the second window to get the value of his allowance refunded. He is thus left substantially in the same position as he is at present and he is not likely to be deceived by the fact that it has taken him two steps to get there instead of one. In so far as these schemes alter the actual incidence of the charge on the individual—and Mr. Chambers' certainly does—it would be possible, if so desired, to achieve the same result under the present system by changing the rates and allowances without any change in the fabric of the system itself. Thus if a single rate of 3s. or 5s. in the £ on the first band of taxable income were felt to be preferable to the present two tier system, it would be quite simple to make this change under the present system.

27. Before leaving this general consideration of the principles underlying these schemes, it is necessary to look at a number of other matters.

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28. *The Effect of the Proposals on the Wage Structure.* It is often argued that the income tax tends to be reflected in the wage level so that ultimately it is passed on to the consumer at least in part in the form of higher labour costs and higher prices. The answer usually given to this argument is that the amount of income tax payable varies from one worker to another according to his personal circumstances, etc., and that there is thus no common figure which could be taken into account in wage negotiations. If, however, everyone were subject to a common rate of tax, so that every £ earned were worth, for example, only 15s., it is a matter for serious consideration whether this might not lead to claims for higher wages.

29. *Effect of Proposals on the Individual Taxpayer.* A number of the people who have put forward proposals of this kind, for example, the Economist, Mr. Chambers and Professor Meade, do not appear to have examined in detail the actual effect of their proposals on the financial position of the individual taxpayer. A scheme which may appear attractive when described in general terms may in fact create such anomalies as between one taxpayer and another as to make it unacceptable. The individual taxpayer is keenly alive to the burden he has to bear and he may be expected to protest vigorously if the effect of a particular proposal is to make him pay more while others pay less. We agree that it is impossible for any major re-arrangement of the tax system to leave the incidence on the individual unaltered and in some cases the change in incidence may be deliberate policy. Nevertheless, it must be recognised that the question of incidence will be one of the major points of interest.

30. *Finance of the Schemes.* The effect of a scheme on the yield of revenue is a matter of primary importance. No one would reasonably expect that a scheme which sets out to make a complete revolution in our public finance would produce the same net yield of tax, due to the last penny, as the present system. But a scheme which costs net, say, two or three hundred million pounds stands in a very different category. It is not simply a scheme to alter the form of the tax system, it is equally a scheme to reduce taxation by £200 millions or £300 millions. Its attractions may well be due as much to this reduction in the level of taxation as to its more revolutionary provisions.

Now is it possible to say that the rates of tax and benefits proposed are merely illustrative and can be altered up or down to make the scheme solvent. There is the world of difference, from the incentive point of view, between the rate of 3s. suggested, for example, by Mr. Chambers, and a rate of over 7s. which would be necessary to make a full-blooded income tax cum social security scheme solvent. But even what at first sight appear to be small changes may have very considerable effects. Thus if under a particular scheme an individual earning £200 a year is neither better nor worse off than at present, but it is then found that the equilibrium rate of tax required is 6s. higher than originally proposed, the effect of this change would be to make him £12 10s. a year worse off.

Part III. The Liberal Party Scheme

31. The development of the Liberal Party scheme has already been set out in Part II of the Note and its main provisions were summarised in paragraphs 19 and 20. Before examining the proposals in detail, we feel we must draw attention to the following points:

(i) The scheme is financed to the extent of £m317 by a reduction in the food subsidies. Of the weekly cash payment of 12s. 6d., 2s. 6d. represents "compensation" for this reduction in the subsidies. The true net value of the cash payment is therefore 10s. a week.

(ii) On the basis set out in the Committee's Report (viz. 1948 National Income, 1949-50 rates of tax and food subsidies reduced by £m317) the scheme would show a deficit of over £m300 compared with the surplus of £m265 shown in the Committee's Report. This point is dealt with in greater detail in Appendix I.

(iii) To make the scheme financially self-supporting without reducing the cash allowances or increasing the rates of tax on the higher incomes, it would be necessary to increase the flat rate of tax by nearly 1s. in the £, viz., from 5s. to 5s. 11d. on earned income and from 6s. to 6s. 11d. on unearned.

(iv) In short the scheme ought to be regarded as one for payment of allowances of 10s. a week and for charging a flat rate of tax of 5s. 11d. in the £ on earned income and 6s. 11d. on unearned income.

(v) The lower rates of income tax were reduced in the 1950 Budget from 6s. and 5s. to 5s. and 2s. 6d. respectively.* A corresponding reduction would be possible in the (corrected) rates chargeable under the Liberal Party scheme. Allowing for the increase in the National Income in 1950, the new rates would be 5s. 5d. in the £ on earned income and 6s. 5d. on unearned. While a rate of 5s. 5d. is naturally more attractive than a rate of 5s. 11d., it must be borne in mind that in comparing the Liberal Party scheme with the present system, the 5s. 5d. rate would have to be compared with the 1950-51 reduced rates of 5s. and 2s. 6d. while the 5s. 11d. rate would be compared with the old reduced rates of 6s. and 5s. To change the year of comparison therefore makes little difference to the relative attraction of the scheme.

32. Although the Liberal Party Committee started with Lady Rhys Williams' scheme as their terms of reference, they early came to the conclusion that "there is an absolute conflict between security and incentive" (paragraph 32) and their proposals represent "a compromise solution". In making this compromise, however, they have in effect rejected the cornerstone on which Lady Rhys Williams' scheme was built, namely, the amalgamation of income tax and social security into a simple comprehensive system under which a guaranteed minimum income sufficient for subsistence was to be paid to everybody. For by fixing their cash allowances at 12s. 6d. a week (10s. net) they are compelled to re-introduce specific benefits for old age, unemployment, sickness and injury. Moreover, to avoid penalising the income tax payer with a family they also re-introduce an income tax child allowance.

33. The scheme, therefore, can make none of the comprehensive claims which have been made on behalf of Lady Rhys Williams' proposals. Whatever merits can be claimed for it are of a more restricted kind. In their summing up the Liberal Party Committee claim the following advantages for their proposals (paragraph 102):

(i) The rates of benefit for the old, the unemployed, the sick, etc., are the same or greater than the current benefits and some of the existing qualifications on the receipt of benefit are removed.

(ii) The basic weekly payments "augment considerably the lowest incomes".

(iii) The insurance contributions are abolished.

(iv) The rate of income tax is reduced to a level less discriminatory than at present.

In paragraph 94 the Committee also claim that

(v) There would be considerable administrative savings both in the Civil Service and in industry.

So far as the first point is concerned, all we would say is that we understand that if the changes were thought desirable they could be made within the framework of the existing insurance schemes without the necessity of creating an entirely new system as the Liberal Party propose. As regards the third point, the question of abolishing insurance contributions is referred to in paragraph 25. The other three points are considered in the succeeding paragraphs.

34. *Benefits accruing to the lowest incomes.* The general claim that the basic weekly benefit "augments considerably the lowest incomes" is hardly borne out by the facts. According to the table annexed to the Yellow Book, the single person with £200 a year is £5 a year worse off, on £200 a year he is £7 worse off and on £400 a year he is £8 worse off. The married couple are £14 a year better off on £200 a year, but £2 worse off on £300 a year and £3 worse off on £400 a year. The married couple with two children are £53 a year better off on £200 a year, £28 better off on £300 a year, £7 better off on £400 a year but only £2 better off on £500 a year. All these figures show the scheme in an unduly favourable light as they are based on a 5s. rate, which, as pointed

* It is proposed to increase the reduced rates of tax for 1951-52 to 5s. and 3s. 6d. and the standard rate to 5s. 6d. The corresponding rates in the present Note are limited to 1949-50 and 1950-51 rates of tax.

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out in paragraph 30, produces a deficiency of £m300. With a 5s. 11d. rate large numbers of people in the lower income groups would be much worse off than at present. Thus the married couple with £300 a year would be £15 worse off; the married couple with two children on £400 a year would be £11 worse off and the married couple with three children on £500 a year would be £22 worse off. More detailed figures are given in Appendix 2 to this Note.

It could be claimed, with rather more justification, that the basic weekly benefit favours the family as opposed to single and childless couples. But as the figures in the Appendix show the benefits are unevenly distributed and their incidence would be difficult to defend. Certainly if the objective is to endow the family it could be done much more simply and much more cheaply by a direct increase in the family allowances or as is in fact being done by an increase of benefit for children under the provisions of the National Insurance Bill now before Parliament.

35. *Improvement in incentive.* The effect of the proposals on incentive is a vital consideration from the taxation point of view. In their conclusion, in paragraph 102, the Liberal Party say: "We . . . have reduced the standard rate of tax to a level much less disincentive than the present". The standard rate (for 1950-51) is equivalent to a charge of 7s. 2d. on earned income (5s. less 1/5th earned income relief). This compares with the Liberal Party flat rate of 5s. (or somewhat more than this if the scheme is to be self-supporting). But in making this comparison, the Liberal Party have overlooked the fact that most people with incomes below £600 a year have no liability to tax at the standard rate at all. There are 19m people with earned incomes below £600 a year but above the income tax exemption limit of £135. Of these:—

6m pay nothing at all

4m pay only at 2s.* (2s. 6d. less 1/5th earned income relief)

8m pay only at 4s.* (5s. less 1/5th earned income relief)

4m pay at 7s. 2d. (9s. less 1/5th earned income relief)

Of the 19m therefore, 18m would pay a higher rate under the Liberal Party scheme than they do at present and only 4m would pay at a lower rate. Moreover, the flat rate tax under the Liberal Party scheme falls on every penny of the income earned while the existing rates fall only on the excess over a given tax free amount. This point is of particular importance where the decision is whether to work or not work at all—e.g., in the case of the married woman or the pensioner. There is no doubt that in these cases the Liberal Party scheme would be a considerable deterrent.

36. It is often argued that a flat rate tax is superior to a graduated tax because additional earnings, whether in the form of overtime, bonuses or extra piece work earnings, would be taxed at the same rate as the basic wage. Thus in paragraph 26 of their Report, the Liberal Party Committee, in examining the present system, say:—

"From the point of view of deterrent from work, the present system of graduated taxation places a heavy burden on marginal earnings: the last £ appears to be (and indeed is) less valuable and less worth earning than the first."

Stated without qualification, the argument that a flat rate tax is better from the incentive point of view than a graduated tax is wrong. It pays regard only to the shape of the two curves of graduation and ignores their relative position. To take a homely example, it is admittedly easier to carry a weight along the level than to carry it upstairs; but nevertheless it is easier to carry a hundred-weight upstairs than a ton along the level. In the Board's view a flat rate of 5s., or more, charged on every penny of the earnings must exercise a greater disincentive effect than the present (1950-51) marginal rates of nothing, 2s.

* The rates given are for 1950-51. For 1949-50 the effective rates were 2s. 5d. and 4s. 10d. respectively, but as mentioned in paragraph 30 above, if the scheme were to be self-supporting, the flat rate which would have been required for that year would have been 5s. 11d. in the £. The point made in the Note is, therefore, equally effective whether the comparison is made on 1949-50 rates or 1950-51 rates.

and 4s. charged only on the top slice of the earnings. In this connection it is well worth quoting the Liberal Party's own criticism of Lady Rhys Williams' scheme:—

"We feel there can be doubt that 6s. 8d. in the £ is too high a rate of tax . . . It is true . . . that almost every married couple is better off as a result of [the scheme]; but the fact remains that today no tax at all is paid by married workers earning less than £225 a year, £300 a year if they have one child, £350 a year if they have two children or £400 a year if they have three children, and the imposition of a tax of 6s. 8d. on every £ they earned would come as a considerable shock . . . Although it is indisputable these couples will be better off, it will not be apparent to them and we fear that they may appreciate their benefits less than they resent their taxation, with the result that a rate of 6s. 8d. might be hardly less disincentive than it would be if it were not accompanied by the benefits of the scheme . . ."

These criticisms apply with equal validity to the Liberal Party's own scheme.

37. It is sometimes said that the "jump" in liability which occurs when a man passes from the 2s. (effective) rate to the 4s. (effective) rate operates as a psychological disincentive. The same point used to be made about the transition to the standard rate but that complaint was largely met by the increase in the width of the upper reduced rate band (chargeable for 1950-51 at 4s. effective rate) to £200 in 1948. To the extent that there is any point in this criticism the Liberal Party can claim that their flat rate chargeable up to £600 avoids the "jump" in liability. But in the Board's view the point is a small one and if valid it could equally well be met under the existing system by charging the first £250 of taxable income at some intermediate effective rate between 2s. and 4s.

38. Our general conclusion must be that on grounds of incentive the Liberal Party scheme is much inferior to the present system.

39. *Administration.* It is claimed on behalf of the scheme that it would save much work. In paragraph 94 of the book it is said:

"It should also be borne in mind that the scheme would result in considerable administrative savings both in the Civil Service and in industry. The abolition of P.A.Y.E. 'coding' for incomes below £600 would relieve both industry and the Inland Revenue, and the abolition of National Insurance Contributions and the stamped card system would make the Ministry of National Insurance largely redundant . . . It is clear that [these savings] would be considerable and would far more than offset the cost of administering the 'Personal Allowances' of the scheme we propose."

So far as the Inland Revenue is concerned there is no doubt that the scheme would mean a substantial saving in work. This saving is not as great as might at first sight appear for in certain directions the scheme involves additional work, e.g., in dealing with the half million small traders at present not liable to tax, in assessing and collecting tax on subsidiary items of income at present dealt with through P.A.Y.E. and so on. It would also be necessary to "test" cases below £600 a year periodically to see whether there were any sources of untaxed income. Nevertheless we should put the saving in Inland Revenue staff once the new system had become properly established, at 10,000 to 15,000. There would be no saving in the period of transition to the new system. There would also be a considerable saving in industry but we are not in a position to quantify this. It is understood that while the abolition of insurance contributions would result in considerable savings in the Ministry of National Insurance, the administration and control of the payment of "personal allowances", which, in effect, would be an extension to everyone of the present system of Family Allowances, would involve handling about 27 million claims compared with 3 million under the present Family Allowance Scheme. This could only result in a very substantial increase both in staff and administration costs. A system of insurance benefits to cover unemployment, sickness, retirement pensions and widows' benefits would continue under the Liberal Party Plan and presumably these would be little or no savings in that direction.

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EXAMINATION OF WITNESSES

561. Chairman: Mr. Cockfield, I understand that you and Mr. Beales are here from the Board of Inland Revenue and Mr. Williams and Mr. Edwards are from the Ministry of National Insurance?—Mr. Cockfield: Yes, Sir.

562. I shall start first with you Mr. Cockfield because my questions relate to your figures. I do not want to repeat the questions I put to Sir Arthur this morning—I think you were here?—Yes, I was here.

563. When I was criticising Table 1 of the Liberal Party's supplementary memorandum you heard the questions I put; did you agree with the figures upon which I based them?—Yes, entirely. I have since this morning's hearing had the opportunity of seeing the figures which the Liberal Party were using in making up their figure of £1,161 million as contribution to Government expenditure. If you remember, we thought that figure should be £1,137 million. The difference between the two consists primarily of a difference on the figure for tax reserves, but they have also included a saving of £10 million on National Assistance which was a figure which we did not ourselves include. You will remember that in the scheme as presented in the supplementary document the net benefit going to the married couple whether unemployed, sick or aged, was rather less than the existing benefit, namely 40s. against 42s., and we thought therefore that the saving on National Assistance was not likely to be very material, but if that benefit is increased to 42s. it may be that there is some marginal saving on National Assistance. It is rather difficult to quantify but it is certainly only a matter of a few millions.

564. It would not substantially affect your estimate that if their figures were corrected, as you say they ought to be, it would involve about an extra 1½d. on the income tax as they contemplate it?—Yes, that is so.

565. I think I ought to put this question to you: the whole of the Board of Inland Revenue's Memorandum was based of course, so far as the Liberal Party were concerned, on their original proposals?—Yes.

566. They have to some extent modified them in their supplementary memorandum and they have corrected their figures?—Yes.

567. So far as the figures are concerned, you have in effect given us your revised figures as to the balance sheet, but I thought perhaps I ought to ask you whether there are any other corrections that you wish to make in your memorandum in view of the revisions that they have made and the alterations they have suggested in their supplementary document?—No, there is really nothing else to be covered. The rate of tax they propose is precisely the same as the rate proposed in their original document and in our view, therefore, the effect on incentive would be precisely the same. If you remember, the remarks we included in our memorandum were directed primarily to the scheme as it was presented in the Liberal Party document, and we said that we thought that a rate of tax at 5s. in the pound falling on every pound of income was more disincentive than the present system, and that of course is equally true even if one takes into account the revisions which have been made in the later document, because they maintain the rate at 5s.

568. Yes, but let me just put this to you: you will remember that Sir Arthur criticised your paragraph 35, which is the one that deals with disincentives, on the ground that you had omitted from your calculations the contributions under social security—in the passage in his evidence which began "Well, well . . ." First of all, can you tell me whether in fact you had omitted those contributions in the calculations you made?—May I submit to you, Sir, that the question of the National Insurance contribution is completely irrelevant from the point of view of incentive. What causes the disincentive effect of taxation is the impact of the tax on marginal earnings, that is, if it lies within the power of a man to say whether or not he will work overtime, if you then take away from him in tax part of his earnings he may be inclined not to work that overtime. Our argument, very simply, is this: under the existing scheme there are 6 million people who pay no tax at all, no income tax at all; they could not possibly have been deterred by income tax from working overtime because they paid no tax. Under the

Liberal Party scheme they will pay 5s. on every £1 of overtime they earn, and our point very simply is that a man is more likely to work overtime if you pay him 20s. in the pound than if you pay him 15s. in the pound, and from that point of view the National Insurance contribution is quite irrelevant.

569. I put that point to Sir Arthur this morning. I think he suggested that that comment left out of account the fact that they would be drawing the 10s. personal allowance which they do not at present?—Yes, Sir, that is true, but they draw the 10s. personal allowance whether they work overtime or not, and when therefore the man comes to make up his mind whether he is going to work overtime, what he will look at is the 5s. which will be deducted from the overtime.

570. The only other point I think on which I want to touch myself, although I expect my colleagues will have more questions to ask you, is the question, rather important from one point of view, of the effect of the adoption of the scheme on the sum total of civil servants who would be employed by His Majesty's Government. You told us, in paragraph 39 I think it is of your memorandum, that you reckoned that there would be a reduction of from 10,000 to 15,000 in the numbers employed by the Board of Inland Revenue itself, that is right, is it not?—Yes, Sir.

571. I think we would like to know 10,000 or 15,000 off what; leaving out of account of course any employees of the Board of Inland Revenue who have nothing to do with income tax?—The 10,000 to 15,000 is the net saving in staff of the Chief Inspector's Branch which is mainly concerned with the computation of liability to income tax, as well as various other duties, and setting off against that the additional staff required on the collection service. The existing staff of the Chief Inspector's Branch is just over 31,000.

572. So you reckon a saving of anything up to one-half?—Yes.

573. I take it that in arriving at that net figure of 10,000 to 15,000 you have allowed for the fact that presumably you would have a much larger number of returns if everybody is taxable than there is at present when you can ignore some 6 million people?—The existing position is that we issue about 15 million return forms a year. We do not in fact issue a return form to everybody every year because some people are not liable to tax, and it is only necessary therefore to check their position periodically. Under this scheme it would be necessary to issue a return form to everybody above the £600 limit, and it would also be necessary periodically to test the people below £600 to ascertain whether or not they had any liability to tax other than that on their wage or salary. The total number of returns issued on average would be rather less than the number issued now, and that we have taken into account in making these savings. The main set off, if I may use that phrase, against the saving in staff arise in other ways. There are a very large number of things which would have to be done under a scheme of this character which it is not necessary to do at the present moment. One of those was mentioned this morning in the course of the evidence, namely, dealing with the liability to tax under Schedule D of traders who at the moment are written off as not liable.

574. Some half million that is?—There are about half a million of these people and under this particular scheme every one of them would be liable to tax at 5s. in the pound on every penny of their profits. To take a very simple example, the married man with two children does not now begin to pay tax until his income is about £400 a year; consequently, subject to periodic check, a trader with an income below that level, if we knew he was married with children, we would write off. Under this scheme the tax payable is £100. That is a very serious matter. You must get from him not only a return, but you must make a very careful effort to see that you have the right amount of income, and one would therefore be faced with dealing with half a million of these cases which are far from straightforward in addition to those which we deal with already. There is also a very substantial increase in work in certain directions with the ordinary wage and salary earner. One of the great advantages of Pay as You Earn

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which is perhaps often overlooked is that it does succeed in sweeping up with comparative ease the miscellaneous adjustments on a man's tax liability. For example, if a man has a salary and also owns his own house, we do not raise a separate assessment on the house and come along to him and collect the tax: we set off the net annual value of the house against his income tax allowances in arriving at his code number for Pay as You Earn purposes, and the tax is collected quite automatically week by week and at the end of the year the right amount of tax has been collected, no assessment is made, and that is an end of the matter. But under a scheme of this nature where you have no coding at all, where the employer merely deducts 5s. in the pound, you cannot possibly take the net annual value of the house into account in dealing with the tax on his weekly wage; you have to come along at the end of the year and raise an assessment on it and collect the tax specifically. We cannot give you an exact figure for the total number of people below £600 a year owning their own houses, but I feel there must be several millions of them.

575. You have taken all that into account, but still think you would have a saving of 10,000 to 15,000?—We have tried to be perfectly frank about this. We think, taking all these factors into account, the scheme would still show on the Inland Revenue side a saving of between 10,000 and 15,000.

576. Of course, in your memorandum you say that that saving would be more than offset by the increased staff that you think the Ministry of National Insurance would require?—Yes Sir.

577. That statement was received, if I may say so, with considerable scepticism by Sir Arthur this morning, and I want to know a little more about it. Should I address my questions to you, or would you rather Mr. Williams answer on this?—So far as that side is concerned, I think my colleague Mr. Williams is in a much better position to answer your question than perhaps I am.

578. I will put it this way; the suggestion was this, that there was nothing very complicated in issuing books of coupons when everybody had to have them, their qualifications did not have to be investigated. It was not a question of seeing whether they had paid a certain number of contributions, it was simply a question of issuing the book to everyone. It was suggested, therefore, that it was difficult to believe that that would require an addition to your staff of some 10,000 or 15,000 persons. I use that phrase because I do not want to distinguish between gentlemen and ladies for this purpose, for what Sir Arthur thought a rather simple job?—Mr. Williams: On the basis of 38 million people, I have deliberately . . .

579. I thought it was 50.5, the figure we were given?—The children would be taken in with the adults, that leaves us 39 million and on the basis of 38, allowing for a certain loss, the extra staff would amount to 28,000. That is quite apart from doing away with contributions, I would like to come to that separately. It is based . . .

580. I do not mind when you do it, but some time I want to know what the 28,000 people would be doing?—I am afraid I should have to go into some detail.

581. Certainly, we want it because your figures have been challenged and therefore we want the full justification for them.—The cost of issuing the books at Newcastle, or wherever else we might propose to do it, would be 26,500 staff. We already employ 4,500 there in issuing books to pensioners and issuing family allowance books. I have deducted them, thus leaving a net 22,000. Then in the local offices we should require altogether 11,500 to deal with people on the spot, to record their changes and take new claims. We already employ 3,500 on similar work in connection with pensions, so that leaves a net 6,000 extra in about 1,000 local offices.

582. That makes your extra 28,000?—Yes.

583. Going away from that, I would like to ask you this question: Lady Rhys Williams in her supplemental memorandum has suggested that the issue of these books, which have to go one to every person in the population, just as in the case of ration books, could be quite simply done by the same staff and at the same time?—I can only say in reply to that that our system of issuing family allowance books which is what I am basing this on, is highly mechanised. It is done in the cheapest possible way and

it would be quite impossible to do anything on a local basis at anything like that cost. It would cost a much greater number of staff to do it.

584. What struck me about it is this: that when you are dealing with pensioners and the like there are a lot of things you have to check as to the person's right to receive the book. When you are issuing one book to every person, every man woman and child in the country, that checking disappears and the only thing you have to see is that you do not issue two books to the same person. I should have thought that was a simpler operation without requiring the same staff for checking that you would have under the old system. I think that is what the suggestion is, and I would like your comment on it?—The only way to avoid issuing more than one book to a person is to have a record and to mark against that record when a book is prepared and sent out.

585. Yes, but one would have thought, pursuing Lady Rhys Williams' suggestion, that if that process is just as essential where ration books are concerned as it would be as regards coupon books and if the two were issued at the same time by the same person, why could not one person do both checks?

586. Mr. Hicks: Why should they not put the coupons at the end of the ration book?

587. Chairman: That is another suggestion. In either way, could not the work be done by one person instead of two?—That might effect a saving on the issue of ration books, but the two things are rather different, one is money and the other is a piece of paper which, if it has any money value at all, is only an illicit one. We cannot issue books worth £26 each . . .

588. In a sense the ration book is just a bit of paper, it is a bit of paper which if you had not got it would leave you to starve or be deprived of some of the essential elements of your diet. I observe that Lady Rhys Williams suggests that we should have to combine your Ministry with the Ministry of Food. I do not propose to go into that aspect of the question, but I cannot for the moment see why the same man should not be able to do both jobs. The check in the case of the ration book is, I think, the production of the identity card. Why should that not be equally effective in the case of coupons, unless you have reason to believe there are a number of forged identity cards?

589. Miss Sutherland: Would you not have to have some check on the cashing of the coupons which you do not have with ration books, because if they are worth 10s. each there is the possibility that they might be stolen out of another person's ration book?

590. Chairman: I am coming to that. Mr. Williams has not yet dealt with the question of collecting the money, he is at the present moment dealing with the question of how you get the coupons into the hands of the beneficiary. I think I am right in saying it is suggested that should be done either through the employer or the Post Office. I do not think you have got to the question of honouring the coupons?—No, not yet.

591. Mr. Kaidor: You say you employ 4,500 people now to issue family allowance coupons and old age pensions together; how many million people are affected by these two schemes?—7½ million.

592. It is true, it is not, that in each of these cases you have to check that the people in question are entitled: in other words, that there are children under 16 years of age and with new children the production of the birth certificate is required, and you have to check that they were resident in the country for the period in question, and the same with old age pensions. Would not the greater part of the work of these 4,500 people be concerned with this checking, the checking of entitlement to the allowances or pensions?—The work you speak of arises when a new claim is made or some change occurs. Most of the work which I have cited here is concerned with issuing renewal books once a year or issuing new books on a change. There is no elaborate checking except that on the first claim you must make sure that there is such a child, speaking of family allowances, and that he is living with his mother or whoever is claiming.

593. Chairman: 26,500 merely on this thing seems such a very big staff, that is the first impression?—It is about 700 staff per million claims.

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594. Mr. Kaidor: It would be interesting to know how many people the Ministry of Food employs in connection with the issue of ration books.

595. Chairman: It would not be fair to expect Mr. Williams to answer that, we can find that out through the Secretary afterwards. At any rate you think you would require 20,000 extra staff purely in connection with the issue of the books, that is right, is it not?—Yes.

596. Let us pass from that to the question of how the coupons are to be met. Do you visualise extra staff on that, or would that be done through the Post Offices, or how?—The simplest way of all would be to do it through Post Offices. That is, if they could handle the traffic. The cost for the Post Office is about a quarter of a million pounds per million claims, so that is £4½ million.

597. The cost?—That is the total cost we should have to pay the Post Office.

598. That is not the 10s. per coupon?—The present cost is £4 million for every million books current. If you take that same cost, it would be £4½ million.

599. Mr. Millard Tucker: That is roughly a present cost of £2 million. There are 8 million people roughly and on that basis, eight times a quarter of a million, it would be £2 million.

600. Mr. Harry Gill: If you put it another way it is 5s. per book, is it not?—That is not the basis of the charge, but that is what it comes to.

601. And that book covers 12 months, does it not?—Yes.

602. Chairman: Does not that look as though the Post Office are having their pound of flesh?—They cash 52 orders a year; it is only about one penny per order.

603. Does that mean that is their estimate of the cost of the extra staff they have had to employ in order to honour your coupons so to speak?—It is not solely staff, there is stationery and accommodation and so on which has to be provided.

604. Have you any idea how many extra staff carrying out the pension work is involved in Post Offices?

605. Mr. Harry Gill: Will not most of them be cashed at sub-Post Offices where the Postmaster is paid on a commission basis?—I do not think perhaps that it is our business to go into what the commission rate is.

606. Chairman: No. On that view it would not involve any extra staff because the sub-Postmaster does it himself.

607. Mr. Harry Gill: I know of sub-Post Offices where they are cashing 1,000 of these a week and it must mean that the sub-Postmaster has got to have some additional staff to do it.

608. Chairman: If the Liberal Party scheme were adopted and there was a great increase in the number of million people that the Post Offices have to deal with, let us assume it was 10 million, you would not expect the cost to multiply by 10, would you, because they should be able to deal with more people without multiplying it by 10? You would not expect to have to pay £2,500,000? Should not there be a reduction in the charge per million people if the quantity went up?—I am afraid it is impossible to answer that, because if the effect were to necessitate in one place a larger office or enlarged accommodation, all that has to be paid for. In some cases there might be some slack which could be taken up.

609. If I have followed you, so far as honouring the coupons is concerned, you cannot give us any evidence as to the quantity of staff required, you can only say what you think the cost might be?—Yes. Could I just add this? What I have given is the gross cost, I have not taken any account so far of any savings on contributions work.

610. I should like information on that.—That is not as great as it would seem. The total staff employed on contributions work in the Ministry is about 9,000, of which 4,000 are at Newcastle running the Records Office and 5,000 are in local offices. If we did away with contributions, I am afraid that, though we might save that work, we should give ourselves additional work because,

apart from their use as a method of raising revenue, they are also a means of establishing a person's employment status.

611. For what purpose do you require that?—Certainly for the purpose of unemployment insurance and sickness benefit. Unless the Liberal Party contemplate that everybody should receive unemployment benefit and sickness benefit for the mere asking, we must employ some test, as of course we do at the moment.

612. What is the test you apply?—It is a test of a certain number of contributions over a certain period.

613. Chairman: They do of course visualise quite clearly that the qualifying period should disappear and that everybody should be entitled to their benefit without any qualifying period.

614. Mr. Millard Tucker: The moment you are born—

615. Chairman: The moment you go to employment and then become unemployed, I do not think a baby of one could claim unemployment benefit.

616. Mr. Kaidor: Is it for unlimited periods?

617. Chairman: I understood Sir Arthur to say quite clearly this morning that under the Liberal Party scheme there would be no qualifying period. All you would have to prove was that you had been employed and you were now unemployed.—So that if a married woman took one week's work and then became unemployed and went to the employment exchange she could then get benefit indefinitely?

618. She has to hold herself as being willing to take employment.—I am afraid it would be rather necessary to look at the lady's past record, though that might not tell us the future. That is the sort of point I wanted to make.

619. You mean there would be some saving as against the 20,000 but not the full 3,000 who are employed on the contributions; is that the position?—Yes.

620. Is there anything more you want to add from your point of view on this question of extra staff before I hand you over to Mr. Tucker?—No.

621. Mr. Harry Gill: There is just one point. Would there not be a contra-savings on the Post Office by not having to issue all these unemployment stamps and so forth, is that not a credit? Just what it is worth I would not like to say, but it is on the credit side.—The cost of that is £1 million a year.

622. Chairman: All told?—Yes.

623. Mr. Harry Gill: Is that the cost including the allowance to sub-Postmasters for commission and so forth?—That is the total cost to us, what we pay the Post Office for serving the stamps.

624. Mr. Millard Tucker: Mr. Williams, I just want to see if we have this quite right. At the present moment there are 4,500 staff dealing with the issue alone of books for family allowances and books to pensioners?—Yes.

625. That is for 7½ million. That is roughly one issuing person to about 1,900 recipients?—Yes.

626. Call it 8 million; Mr. Cockfield is a wizard at figures.—Mr. Cockfield: Each clerk issues 1,900 books.

627. That is what I said, 1,900. I am glad to find my figures are right. You want an extra 22,000 staff for this issuing work plus another 6,000 on the spot; that makes the 28,000?—Mr. Williams: Yes.

628. The number of books to be issued will then go up from about 8 million by roughly 43 million?—No, I should think we should lump them together. If a person in receipt of a personal allowance became entitled to retirement pension the two things would be lumped together.

629. Yes, but instead of dealing with 8 million we are going to deal with roughly 51 million, is not that right?—Yes. I was looking at it from the point of view of how many books we should issue, which I was assuming would be 38 million.

630. I am merely looking at the number of people. If it is an extra staff of 22,000 for an extra 43 million that is an extra person for every 2,400 people, or roughly that?—If you put it on the basis of the number of people,

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yes. I was not thinking of a book per person but one for the family, one for the mother and children.

631. Do the children's allowances go in the family?—Yes.

632. *Chairman:* That would defeat the Liberal Party scheme because that visualises that the mother should receive the children's allowances; if you issue them in the father's book . . . ?—I am sorry, I had assumed they would remain with the mother.

633. *Mr. Millard Tucker:* So the mother gets a book and the father gets a book; that cuts down the amount of work, does it not?—It still leaves us with 38 million.

634. 38 million books altogether?—Yes.

635. You are now issuing 8 million?—Yes.

636. So it is 30 million extra books and 22,000 people to do it, is that right?—Yes.

637. What do they do for the rest of the year?—They are issuing them all the year round; it is done in a cycle.

638. You are not issuing 38 million all the year round, are you? You will have a few people being born of course in the course of a year but everybody more or less has to start on the 1st January with a book, do they not?—No, the whole issue is staggered; one-fiftieth is re-issued each week. That is quite apart from the new ones.

639. *Chairman:* Borrowing the language of holidays, you stagger your families?

640. *Mr. Kelder:* That means that each clerk on the average deals with six persons per day. The working day of a clerk is to issue six coupon books on your calculations?—Yes, but that is not all that he does.

641. *Mr. Millard Tucker:* What does he do with the rest of the time?

642. *Mr. Bullock:* In many cases they correct the mistakes they make.

643. *Mr. Millard Tucker:* I should like to know in all seriousness?—They also correct the mistakes that the claimant makes.

644. *Mr. Kelder:* In the National Health Service a doctor is supposed to be able to look after 2,000 or 3,000 patients . . .

645. *Mr. Millard Tucker:* I am not questioning this; I am just groping for information. It does seem a colossal staff, does it not, for such work, an extra 22,000 people just doing nothing else all the year but issuing these books?—I do not think I have implied that that is all they are doing.

646. What else will they do besides that?—The main trouble of course arises in connection with changes, new births, children becoming adults, people dying, etc.

647. When they become adults they leave their mother's book and go out into the cold world themselves?—Yes; other factors are changes of address and things of that sort.

648. I can imagine there will be a certain amount of clerical work throughout the year, but it does seem a very high proportion of staff to the number of beneficiaries?—We have also to account for the money that is paid.

649. What I want to ask is in making your estimates have you taken your present basis of 4,500 for 8 million and then roughly done a little multiplication sum, or on what footing have you based the estimate of the increased staff?—I have taken the cheaper of the two operations, that is to say the banding of the family allowance books; I have based it on that.

650. Because one of the witnesses said—"Won't this be a colossal amount of work for somebody" they rather pooch-pooch him, but you seem to support it—there is a lot of work?—Yes.

651. And a considerable amount of expense incurred in doing it?—Yes.

652. What would be the average remuneration of these 28,000 people, £300 a year?—I should say about £400 now.

653. Come on Mr. Cockfield, how many millions is that per annum?—*Mr. Cockfield:* For the additional 22,000 it is about £9 million.

654. I see, according to the Royal Commission on Population, that the average annual births per annum for 1946 to 1948 was 934,000, and the deaths are about 357,000. That means you have roughly 1,500,000 new entries and changes to make during the course of the year, that is the changes you are talking about as to extra work?—*Mr. Williams:* Plus changes of address.

655. Then on top of that you have the birds who leave the nest; what else besides that?—Changes of address, people going abroad . . .

656. They still get their money if they go abroad?—Not if they go outside . . .

657. *Chairman:* Not if they settle.

658. *Mr. Millard Tucker:* It is true to say—what is the figure Mr. Cockfield?—*Mr. Cockfield:* £9 million a year.

659. *Chairman:* That is of course without the deduction in respect of your savings?—Yes, that is so.

660. *Chairman:* Later on when Mr. Tucker has finished I will ask you for the net figure.

661. *Sir Harry Gill:* I do not know whether this work has ever been scientifically measured. I should imagine there are two phases of the work we have been talking about, the issue of a card and all this extra work of changes, ins, outs, transfers and so forth. Would you say over all that the mere issue of the card, the mechanical issue of the card, is the smallest portion of the work in connection with a case, looking at each individual as a case? Are the clerks with regard to eligibility, changes and so forth the cause of more work than the actual mechanical writing of a card?—*Mr. Williams:* Yes, most certainly.

662. *Mr. Millard Tucker:* But, Sir Harry, the individual can only die once.

663. *Sir Harry Gill:* He can move twice a week; he can only die once and only be born once. I can see a considerable difference between the merely mechanical process of writing a card and the other processes; to know that the card has been correctly written and that in fact it should be written at that time, and that it should go to so and so. As I understand it now, our friends say that these clerks outside the writing of the card cost more work than the actual process of writing the card?—I may say that we do not write the card at all; it is all done by machine.

664. *Miss Sutherland:* But it is the same point. For instance, take the Board of Trade clothes coupons during the war. They were issued at the end of the ration books and the Board of Trade's responsibility ended when they had got them carefully worked out so that they were not easy to forge. When they got them out with the book you wrote your address on them, and the Board of Trade was indifferent as to what you did with them or what your address was provided the right coupons were spent by someone; they made no attempt to check. But you want to be certain they are being spent by the right person, and you want to keep your records of that person's career in a way the Board of Trade never did for clothes coupons?—Yes.

665. *Mr. Millard Tucker:* So it is not quite right to dismiss sirly the extra staff in this. The cost of the scheme in issuing these books and dealing with them is quite a serious problem in manpower?—Yes.

666. I have asked Mr. Williams all I have to ask him, but there are one or two points I want to ask Mr. Cockfield.

667. *Chairman:* I think we should first complete our examination of Mr. Williams.

668. *Mr. Carrington:* I have only one question to ask. You told us there would be an increase of 6,000 in the number of persons employed at your local offices?—Yes.

669. Would you tell me upon what work they would be engaged?—They would be dealing with enquiries by people who were getting into difficulties with claims and books and so on. They would be dealing with the notification of changes; if a person changes his address he would go into the local office and tell them.

670. That is the callers at your local offices of the Ministry of National Insurance?—If a new child is born they would go into the local office and notify it there.

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671. Would there be any saving of staff if you ceased having stamped cards? In other words would you save anything in manpower by not having to send inspectors round to see that the employers were stamping insurance cards?—Yes, we certainly should, but as I tried to suggest just now part of the saving would be taken up by the extra work we should have to do in dealing with claims for unemployment benefit and sickness benefit in order to be sure that the person was genuinely in the employment field. I think Sir Arthur Comyns Carr mentioned the point himself that an employed person would certainly need some sort of identifying card to say that he was a genuine worker.

672. That would presumably be cross-checked by the Inland Revenue under this scheme?—I think it is more likely to mean the employers having to provide a record of employment.

673. Miss Sutherland: We have been talking about these employees as if they were all clerks. I suppose only a proportion of them would in fact be doing the work concerned with the issue of the cards and you would have others backing them up. What proportion are super-numeraries, people on the back line?—About three-fifths would be clerical staff and the rest messengers, porters, typists, people who work pneumatic tubes and so on.

674. So our rough calculations of the number of cards per person are very rough indeed and do not represent the truth at all?—Yes.

675. Mr. Kaldor: May I ask Mr. Williams one or two more points on this. Taking a 40 hour week, on your calculations each clerk would on the average handle one person per hour of work?—Yes.

676. In answer to Miss Sutherland you just said that only about three-fifths of the clerks would be engaged on that, two-fifths would be some sort of overheads connected with this, but even on a three-fifths basis you would get 40 minutes per claim. Clearly in all those cases where there are no new births, no deaths and no change of address the work cannot take anything near 40 minutes, if it is mechanised it will take hardly any time at all; if on the other hand you take only the people who have to be recorded because of one of these changes I mentioned their number would not be 50 million but perhaps only at a maximum 5 million a year?—I should say it would be much more than that.

677. More than 5 million?—Yes. I did make a rough calculation that, apart from change of address, I just do not know the number of those, one in every four family allowance claims or books has to be withdrawn and a new one prepared and issued every year, so you have got an increase of 25 per cent. straight away.

678. Chairman: Owing to changes in conditions do you mean?—Yes.

679. Mr. Kaldor: Would not that largely arise because of the fact that family allowances are only payable for the second or subsequent children and only up to the age of 16? All these qualifying claims would require, I can see, a great deal of checking. If you simply pay 10s. to everybody in the country and everybody is entitled to the same sum as long as he or she is alive there would not be all this checking?—There is no difficulty about not paying for the first child. It does not require any checking. You simply exclude it; if there are five children you pay for four, there is nothing in that.

680. Supposing you take the number at 10 million, the people who require some extra work every year, you would still get on that figure five times, say, 40 minutes, which is 200 minutes or over three hours of a clerk's actual time to deal with those. You do not think that is excessive?—I do not agree with the basis of calculation but I am afraid I cannot now put another in its place.

681. You have not made at the Ministry of National Insurance any actual tests on the amount of time involved in dealing with a particular change or a particular claim?—I think we know pretty accurately, but I have not got the information here.

682. Mr. Hicks: I wonder whether Mr. Williams has fully allowed for the fact that under the Liberal scheme at any rate everyone is supposed to get exactly the same allowance of 10s. every man, woman and child, and therefore so far as all that side is concerned there is no question about allotting people by status at all or fitting

them into particular groups. All you have to do is to establish that one book is going to one person, not more than one, and nobody is being left out?—My remarks were not addressed to this, they were addressed to unemployment benefit and sickness benefit. Personal allowances would of course be hardly affected at all.

683. But why do the unemployment benefit and sickness benefit require more staff than at present? I can see that they require a good deal of the same staff as at present, that you are not getting rid of staff in the process, but I do not see why they require extra staff?—I do not think I said they did. What I said was that the number of staff that would be saved by abolishing contributions would be partly needed to meet other work which would arise in having no contributions, if you had to make special enquiries and so on in order to determine the person's status. There would be some saving.

684. It means that this 20,000 are not really extra people required in the Ministry of National Insurance?—There would be some saving which I would put at 4,000.

685. Chairman: If I follow you, you do not suggest that there would be any saving or any increase in staff because of unemployment benefit. You cannot want any more staff to deal with unemployment benefit than at present?—On the present level, no.

686. Obviously if unemployment goes up; that is not the point. This scheme would not make any difference on unemployment, that is Mr. Hicks's point. Then he says this: there are no comparisons at all involved in the personal allowance, the only point is one man, one book. What is puzzling him is how this 22,000 extra staff required on that can be required merely to see to the issue of one book for one man. He suggests there cannot be the number of changes...

687. Mr. Hicks: For example I do not see the change of address matter.

688. Chairman: Let me just see if I have your point. You cannot see how the number of changes that take place in a year, extra births or deaths and that kind of thing or people growing up, can accelerate the employment of 22,000 more people. That is the point I think Mr. Hicks is putting?—Mr. Williams: I think the same number of changes relatively will take place whether you have 3 million, or 20 million. If it takes X staff to do 3 million, presumably it would take 10 X to do 30 million.

689. Mr. Kaldor: But do you maintain that the X staff to deal with the present numbers is largely engaged in the mere job of issuing coupons, not in the checking of entitlement? That is my suspicion that you need a large staff now because people only get coupons in so far as they have children who are entitled to them or, with old age pensions, they are of pensionable age and so on. The greater part of this work would automatically be saved if everybody were entitled to the same coupon and all you had to check was whether a person exists, is alive and is in the country?—I have taken the simpler process of family allowances, as I said just now, not pensions which is more complicated.

690. Chairman: What is suggested I think is that you have got these people dealing with family allowances and if you remove all qualifications as a condition of the issue of a book, those same people should be able to assume some more work and it should not be necessary merely to multiply the number of people by the number of extra books.

691. Mr. Kaldor: On Mr. Williams' calculations where there are actual changes there appears to be at least a minimum of 200 minutes involved with a single person per year, and I just cannot see it. Mr. Cockfield, there may be some other way. We were told by Mr. Cockfield that the Inspectors' Branch of the Inland Revenue requires 40,000 people to check and deal with the returns, to assess, to check 50 million income tax cases, is that right?—Mr. Cockfield: The estimated staff of the Chief Inspector's Branch for the year 1951-52 is 31,200. The number of people they deal with is about 21 million, including those who are not actually liable to tax but who necessarily come within the machine.

692. Am I right in supposing that "dealing" here includes everything, it includes preparing an income tax return, checking that income tax return, preparing an assessment, does "dealing" include all that?—It includes

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everything we have to do other than the direct collection where that is necessary, which is handled by the Accountant General's Branch. I did endeavour to make it clear at the beginning that in many cases we did not issue an annual income tax return form; we issue about 15 million a year. Very often of course we do not re-code each year if no changes have been made in the Budget. We may carry forward the existing code number from one year to another. Nor, if I may say so, do we assess everybody at the end of the year under the scheme which at present exists. Where the code number is right and the right amount of tax has been deducted we merely check that and no formal assessment is made.

693. I think you will agree that dealing with income tax is a far more difficult and complicated business than issuing family allowance coupons as such, is it not? I am merely suggesting, Mr. Chairman, that if the Inland Revenue requires 31,000 to deal with the whole administration of income tax, these numbers seem to be very immoderate.

694. Chairman: I thought this was not quite the same thing. Mr. Cockfield was talking about the Inspectors Branch: is not there a Collectors Branch as well?—Yes, there is a Collectors Branch.

695. Mr. Kaldor: The same thing is true about insurance. We are only talking about people involved in issuing coupons, not the work involved in cashing them, and I think it is very much the same distinction.

696. Mr. Crick: Mr. Williams, I think you said you employed about 9,000 people on collecting National Insurance contributions?—Mr. Williams: In collecting and in recording and in supplying information when the claims are made.

697. That would include the collection of contributions from self-employed people?—Yes.

698. Would you say that man for man the collection from a self-employed person is more difficult than collection from the employer or the employee?—In the case of the employed person of course the collection is done by the employer, it is done for us. The self-employed person does his own, and the only point at which we have contact with him is if the inspectors go round and find he has not been doing what he should have been doing.

699. That means that a larger proportion of the 9,000 is attributable to the work of collecting from self-employed people?—No, Sir. We do nothing to collect the money from self-employed people, they do their own contributions and send in their own cards which we record.

700. How do you make sure he does that?—We do that by checking and by inspecting, but we do not employ a large staff to do it.

701. It is quite a small staff, is it? It would not be any set-off against the staff the Inland Revenue would want to collect tax on lower levels from people they now do not bother about?—No.

702. Sir Harry Gill: Just one point. I thought Mr. Williams was on the moderate side rather than making any attempt at exaggeration. I want to put this point with regard to old age pensioners. There are obviously a number of people who are doing some work after they are 65, and that entails sending back the book, examination and all that kind of thing, and I take it that quite a few people are spending their time doing that, otherwise it looks an appalling situation when a man is dealing with one card every hour. With regard to the alteration made by the present Budget, is that work going to be lessened by allowing a man to earn £2 a week without any alteration?—It should make quite a difference.

703. That will save you some staff?—Some staff, yes. May I just repeat that in these calculations I have made I have dismissed all the more difficult work connected with pensions and I have simply taken the family allowances cost as being the cheapest.

704. Sir Harry Gill: There was one point I wanted to put to Mr. Cockfield.

705. Chairman: We are coming to Mr. Cockfield afterwards.

706. Mr. Greenwood: My question is perhaps a little unfair. After what has been said this afternoon I should like to ask Mr. Williams whether he sticks to his figure of 28,000 additional people: if pressed again that would be the definite figure you would give?—I am not going to say that if we were presented with a final scheme and were asked to cost it out we should necessarily come to exactly the same figure, but I think it would be very much like that.

707. Chairman: I think we have put all the questions we want to put to Mr. Williams. Shall we now resume examination of Mr. Cockfield?

708. Mr. Millard Facker: Mr. Cockfield, under the present rates of tax at what stage does a married man without children begin to pay tax?—Mr. Cockfield: For 1950-51 with an earned income it is £225 a year; for 1951-52 it will be £237 10s. 0d.

709. That is a bit on the low side for earnings now, is it not?—The average industrial wage is about £7 10s. 0d., of course there is a big dispersion on either side.

710. Yes, I know, I am just considering this question about incentive. You said a man could do a certain amount of overtime to-day without being liable for any tax?—Yes.

711. Will there be many of those people?—There are 6 million of them who do not pay any income tax at all at the moment.

712. Wage earners?—They are mostly wage earners, they are mostly married men with children. Of the 6 million, just over 4 million are married with children, about 1 million are married without children and rather less than 1 million are single persons, mainly single persons with dependants. You see, if a man has a number of children, he can earn quite a lot before he pays any tax.

713. Yes, on the other hand the urge to do overtime is greater, is it not, if you have a lot of children?—His needs are greater.

714. That makes the urge, does it not?—I should have thought so.

715. Supposing the wage earning population got used to the idea that no matter what you earned you would have 5s. in the £ taken off it, do you think it would be such a disincentive? You would get used to the idea after a year or so; it did not take them long to get used to P.A.Y.E. Once they got used to the idea that everybody is going to pay tax do you think it would be such a disincentive to overtime, for example?—I should have thought it would still have remained a considerable disincentive as compared with the present system under which so many people pay nothing at all on their overtime and the great majority of those who are left pay, if one may take the 1950-51 rates, only 7s. or 4s. net in the £. It does seem to me to be a rather difficult argument to say that if you only put up the rate of tax you increase the incentive to work overtime.

716. Of course, at the present moment, with the lower rates and the £110 or £180 free of tax, the average rate I agree is low, but when a man does overtime and then begins to get into the 9s. 6d. rate he may think that is not worth while?—He may very well do.

717. I quite agree. What I am thinking is, get them used to the idea no matter what they earn. No matter what, they have 5s. in the £ for this purpose taken from them. Do you think that there will be any real disincentive effect?—There is one preliminary point I should like to deal with on that.

718. Please do.—You did mention people liable to the Standard Rate, but neither the Liberal Party scheme, nor indeed any of the other schemes, does anything to reduce the tax on the man liable at the Standard Rate. They impose a supplementary tax the purpose of which is to bring out the total rate paid by people above £600 a year, or whatever other figure you like to take, to what in effect is the existing rate of tax now after allowing for earned income relief, about 7s. in the £.

719. Yes?—So far as those people are concerned, that is in effect the existing Standard Rate payer, the Liberal Party scheme and the other schemes leave that person in exactly the same position as he is at present. The only

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place the argument on incentive can come in is with the people below £600 a year, and the position there at the moment is that the great majority of them pay on overtime a rate of tax which is less than 5s. in the £, and under the Liberal Party scheme they would all pay 5s.: I find it very difficult to believe that if you put up the rate of tax as compared with what it is at the moment you are going to encourage people to work overtime. I should have thought the reverse would have happened.

720. Yes. You are assuming, are you not, that the £600 a year man will be paying tax at 7s. at the moment?—I am perfectly prepared to agree that the figure which the Liberal Party have taken, namely £600 a year, may not coincide precisely with the point at which the individual begins to pay tax at that rate at the moment but, broadly speaking, it does. After all there is a balance of taxable income of £150 which is not chargeable at the Standard Rate, and if one adds that to the personal allowances and takes account of the Earned Income Relief . . .

721. And the child allowance . . .?—The personal allowances generally, that is single personal allowance, married personal allowance, the children's allowances, the dependent relative allowance, housekeeper allowance, whichever may be appropriate in the individual case, one comes out with a figure which is about £600 a year. In the various proposals presented by Mr. Haynes and Mr. Kinton, they did in fact compute a starting figure for their supplementary tax which was precisely the same as the starting figure for liability to the Standard Rate under the present system.

722. Reverting to this question of saving of staff of the Revenue, you seem to agree that there would be a saving of 10,000 to 15,000 staff in the Inland Revenue?—That is the figure we put in our original memorandum, and we adhere to it.

723. Mr. Williams on the other hand says there will be an increase of staff of the Ministry of National Insurance of 28,000. That is the final figure, is it not, 28,000? So that if those figures are right we should be adding 13,000 further employees in the Civil Service?—It depends whether you take our upper figure or our lower one.

724. I am taking your upper one because it is the most favourable. You say you might save 15,000 people?—We said 10,000 to 15,000. Perhaps I may say this: one of the difficulties we were up against in computing this figure is that none of the schemes, and I am not in any way criticising them for it, goes into real details. Therefore one does not quite know what we would be expected to do under a scheme of this character, and a certain amount of imprecision in the estimates is therefore inevitable.

725. Is that saving of staff mainly in the Inspectorate Branch?—No, it is entirely clerical; it must be so because the Inspectors' main jobs are first of all the responsibility for the running of the offices and, secondly, dealing with trading accounts. Now under this scheme you have more trading accounts to deal with, not less.

726. I am sorry, Mr. Cockfield, for using a wrong expression. I thought you were dealing with the two branches in the main which you call Inspectorate on the one hand and Collection on the other. I did not mean to say it would reduce the number of Inspectors necessarily but the numbers employed in what I call the assessing branch as opposed to the collection branch. Is your 15,000 mainly in the assessing branch?—The position is that there is in the Chief Inspector's branch a saving greater than the total figure, and there is an offset against that in the collection branch. Under this scheme there are a very large number of items of income which would have to be assessed separately and where the collector would have to collect the money from the individual taxpayer instead of its being dealt with automatically through P.A.Y.E. as at present.

727. For example, I suppose, everybody becomes liable to tax including the infant whose godparents have put a few pounds into the Savings Bank for it?—Theoretically, yes.

728. That would be done by deduction?—One could do it by deduction.

729. There would be no question of repayment claims, would there?—Not in that instance.

730. I mean you would have no such repayment claims as you now have by people with small incomes for recovery of tax deducted from dividends?—The difficulty with a scheme of this character is that one has two rates of tax applying to unearned income. One has in effect a 5s. rate applying to incomes over £600 and a 6s. rate applying to incomes under £600. At what rate of tax are you going to deduct?

731. I think the answer would be that you make all these people surtax payers: it would be a great compliment to them. They would be able to say "Now I am a surtax payer", the moment they go over £600. You do not want two or three lots. You would have one Standard Rate and then . . .?—You would then have direct assessment on the people over £600. That in effect, if I may say so, is what we assumed in making these computations. It is not the only possibility but may I return to the question of the interest? Is the point which you are putting to me that you should not deduct the tax from the Post Office interest but recover it by direct assessment?

732. No, no, that means more work.—I should have thought it did.

733. That means 50 million returns a year.—But unfortunately there is no clean solution to any of these problems. If for example one deducts tax at 9s. from Post Office interest one is all right for the people over £600, but one then has to repay the people under £600. Exactly the same position applies in the case of company dividends.

734. I am coming to that. How under this scheme would you deal with company dividends? I presume the present system of the company paying the tax on the whole of its profits and then deducting the appropriate amount from its dividends would be maintained as far as we know?—What would then happen would be the company would deduct tax at the Standard Rate. It would be all right for the people with incomes above £600; for the people with incomes below £600 you would have to make a specific repayment.

735. *Chairman:* That depends what you take to be the Standard Rate. If you took 5s. in the £ as the Standard Rate, the alternative would be you would increase the number of people who would have to pay what in effect are surtax returns.—Exactly. You get caught in one difficulty or the other. It was for this reason we thought it necessary to draw attention to this problem in our original memorandum.

736. Mr. Millard Tucker: As I understand the Liberal Party scheme, companies would be taxed on the footing of 6s. on undistributed profits up to some figure and 5s. on the same undistributed profits up to another figure, what figure I am not sure?—I do not think they intended that at all. I think what they intended doing was to charge the company 5s. in the £, namely 6s. plus 1s. on the whole of its undistributed profits. As a matter of practical administration one would do exactly what one does at present, that is, charge them 5s. in the £ on the whole of their profit and leave them to recover 1s. from the party they pay out as dividends.

737. They would deduct 5s?—Yes, then one would be left in the unenviable position of having to repay all the people below £600.

738. Would you not have to make more repayments then?—Yes.

739. On the whole it would increase the number?—Yes. One of the real difficulties with this scheme is that while at present so many of these miscellaneous difficulties, such as small items of subsidiary income or small items of dividends where tax has been deducted at the Standard Rate can be swept into the P.A.Y.E. coding and dealt with automatically, under this scheme in most instances you have to take each item and deal with it specifically.

740. That is what puzzled me, as to how you got such a saving of staff, as big as 15,000 out of 31,000?—The criticism we were subject to before was that the figure ought to be greater than 15,000.

741. I know, but what I am trying to find out is why you are able to save such a great amount as 15,000 out of 31,000. It is half.—The answer is that as regards the great majority, not all but the great majority below

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£600 a year, the system is genuinely more simple than the present one. As far as we are concerned we would only issue return forms to this class of person every third year. There would be no code number to go to the employer and probably, unless there was other income, there would be no check at the end of the year.

742. No?—And this does represent a substantial saving against which all these other items must be set. We did, in fact, do a detailed computation of the staff we would require and the difference between that figure and the existing staff is this saving which we have put to you.

743. Yes?—The actual saving came out at 10,800, but because of the impracticability of the original scheme with which we were dealing we thought perhaps it was fairer to give a round figure of 10 to 15 thousand rather than tie ourselves down within a couple of hundred.

744. Yes. You get the same repayment claims in any event in cases where there is bank interest payment?—You do.

745. You get the same repayment claims as you get now for charities?—Yes. Presumably they propose to continue the existing exemption in favour of charities which, after all, is very old established.

746. We are not dealing with that for the moment, we are assuming that they will. You would still have those?—We would still have those.

747. Building Society interest?—It is a little difficult to see just what they propose to do about Building Societies. This is one of the real problems of administration. If, for example, a man has bought a house with a mortgage from a Building Society, it is not uncommon in these days to find that the allowable interest is greater than the Schedule A Assessment. At present in these cases we give the additional allowance in the P.A.Y.E. coding. Under this scheme it would have to be by way of a specific repayment.

748. Yes, I see.—Assuming of course, the man was under £600 a year.

749. Thank you, Mr. Cockfield. That answers all I want to know.

750. Mr. Carrington: The only question I want to ask is this. Have any attempts been made to simplify P.A.Y.E. since it was introduced in 1944 or 1945 and if so have those attempts been successful?—Yes, an enormous amount has been done in that direction. Perhaps I might quote one particular thing, namely the introduction of what started by being extra-statutory non-assessing and which subsequently became statutory non-assessing. Under the original scheme it was contemplated that at the end of the year an assessment would be raised on every single individual coming under P.A.Y.E. We came to the conclusion that this would impose upon the Department an impossible burden of work. In most instances the amount of tax involved was frightfully small and we did obtain the authority of the Chancellor not to raise assessments over a wide part of the field, and subsequently we were given statutory authority to do that. That has saved an immense amount of staff. There have been other devices which have been introduced. For example, when we started with P.A.Y.E. it was contemplated that when the allowances were altered in the Annual Budget, everybody would have to be re-coded. After a year or two we hit upon an ingenious device under which in most instances we can alter the value of the code number in the table instead of altering the coding for the individual taxpayer; this has meant that when there have been Budget changes the amount of work involved has been very greatly reduced. It has always been our object throughout to try to streamline the procedure under P.A.Y.E. to the utmost extent.

751. Have you made any attempt, if so with what degree of success, to cut down the employer's work by simplifying the code tables and the literature published with the code tables?—I think the point there really is that the amount of work which is imposed on the employer under the present system is quite inevitable if you start from the point of view that you must collect tax during the year which is the right amount of the liability. You can ensure that you collect the right amount of tax by the end of the year without subsequent adjustment only if you have a cumulative system of the kind

that we have under P.A.Y.E., and if you ensure that when the man moves from one employer to another cumulation is continued. It is the position, however, that the larger employers have been able to introduce a very large measure of mechanisation in dealing with the tax deductions and to integrate them with their ordinary pay roll procedure.

752. Your tax tables though are simpler, are they not, than they were five years ago?—The tax tables are different from what they were five years ago, and the great merit of the new table is not that it imposes less work on the employer, it might indeed be held that it imposes more, but that it is very much smaller and if you have a change in the Budget which involves the production of new P.A.Y.E. tables you can do them very much more quickly than you could with the old type of very large table.

753. The old table was about the size of a London telephone directory, was it not?—It was considerably larger, because almost a complete shelf of my bookcase every year used to consist of a complete set of P.A.Y.E. tables, and I believe they contained about 30 million separate computations. But they did take about six months to produce, and it was felt by the Chancellor that it was quite impossible to have a time lag of six months between the date of introduction of a Budget and the date when changes of taxation were reflected in the pay packet. And, as you will have seen this year, we have succeeded in getting that time lag down to very reasonable proportions. The new tables this year were introduced on the 25th May following a Budget statement on the 10th April, and that is entirely due to the introduction of this new kind of table.

754. Mr. Hick: I am not sure whether this is quite the right moment to introduce this, but the question which I should like to ask at this point is rather something of this kind. Supposing that the proposal which was under discussion was varied in this particular way: that instead of being asked what would happen if everybody was made liable to income tax in the sort of way that has been suggested, the proposal had been put in this form: that the income tax exemption limit should be raised so as to bring no larger a proportion of the total population liable to income tax than was the case, let us say, in 1938, that the present social insurance contribution should be abolished, but that in place of that contribution and at the lower end of income tax, a new tax should be introduced, or new contribution we might call it, which was to be on a more or less proportional basis, but the exact conditions of which—such as what income was to be liable to it, what exemption if any was to be given and so on—could be discussed *de novo*, discussed entirely from the point of view of what was the fairest system which could be brought about within that frontier in order to get a reasonably inexpensive system of collection and assessment. It would probably be the case, I imagine, that it would not be necessary, since the thing would be quite separate from the ordinary income tax, to give some of the more elaborate concessions in such a tax as are given in the ordinary income tax. The fact that it would be a substitution for the definitely less carefully adjusted arrangement of the post-tax contribution would mean that you could afford, you would be securing, a greater degree of fairness, even if you were rather rougher than you were in the ordinary income tax. Have you given any thought as to what possibilities there are in that type of arrangement?—This is of course a very interesting suggestion. As I understand it what you propose is that the existing income tax should be confined to what I might describe as the middle and upper income groups, and that the low groups should be subjected to an entirely new tax of a much simpler kind.

755. Yes?—I think all I can say at this stage is that if one introduced a new tax of that character it would probably have quite considerable advantages in some directions but you would almost certainly have disadvantages in others, and the problem which one is faced with is weighing the advantages against the disadvantages to see whether on balance the scheme was an improvement on the existing one or not. One would like to see a scheme of that sort in rather more detail before committing oneself to what is in fact the advantages or disadvantages were.

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756. Mr. Keldor: I want to ask Mr. Cockfield, rather thinking on the same lines as Mr. Hicks, instead of presuming for the moment the question of what would happen if you bring everybody into income tax, what would happen if you reduced a number of people now liable to tax. Incidentally in your figures in paragraph 35 of the Inland Revenue Memorandum you mention that there are 19 million people with earned incomes below £500 but above the exemption limit of £135 a year. Of these at present six million pay nothing at all. In addition I take it there may be about three million people, roughly speaking, who have earned incomes under £135 a year. Would that be correct?—We have no precise information ourselves about people whose incomes are below the income tax exemption limit, but a comparison of our figures with what other data is available suggests that there are several million people with earned incomes below the income tax exemption limit. Whether the figure is precisely three or rather different I am not in a position to say, but obviously three is not far wrong.

757. So the Liberal Party scheme or Lady Rhys Williams's scheme would bring in nine million additional people to income tax?—It might well do so.

758. You say four million people pay only 2s. in the pound at present and a further eight and a quarter million pay 4s. in the pound. Have you any figures of how much money they bring in, the four million people who pay only 2s. in the pound?—We can supply you with such information. The total amount of income paid by the people paying at 2s. is obviously very small because their average taxable income will be, say, just under £25. Their tax bill therefore, on average, is about £2 10s. a year and four million of them therefore would pay in the aggregate £10 million.

759. Could you not this figure if you take the administrative costs involved in collecting £10 million from four million people?—The cost is obviously very small. The total cost of running the Inland Revenue Department is only between £20 and £30 million, and that covers all our 21 million customers, some of whom, of course, are very large companies where the amount of work on the accounts may be very substantial indeed. The cost per head for the small taxpayers is very small.

760. Yes, I see. And you have not any figures to show, if the exemption limit were reduced so as to put it beyond most if not all wage earners and then abolished P.A.Y.E., what sort of loss that would imply in smaller revenue?—There is a very difficult technical problem there if I may put it, and that is this: suppose you raise the effective exemption limit for the married couple so that it becomes £500 instead of being £225 with Earned Income Relief as it was in 1950-51; it is admittedly true that the tax paid by the people below £500 who would then be exempted from tax may not be very substantial, but you cannot exempt the man earning £499 altogether from his tax and continue to charge the man whose income is £501 the existing tax bill which may amount to a fairly substantial amount. One must therefore, as it were, taper off the relief above £500. If one does this by the simplest method which is a very big lift in the personal allowances, the aggregate cost of it runs into several hundreds of million pounds, not because of what you give to the people below £500 but because of what you give to the people above £500.

761. Mr. Crick: In paragraph 39 of your document there appears this passage—after stating your manpower savings in Inland Revenue: "There would also be a considerable saving in industry but we are not in a position to quantify this." Was any attempt made when P.A.Y.E. was introduced to guess at the burden in terms of manpower that this scheme was to impose upon employers?—Well, Sir, if it is guesswork which you are content with, I am perfectly prepared to make some current guesses, but I ought quite frankly to say that we have not the information on which to make an estimate which I would be prepared to support as being entirely accurate.

762. I would far rather have a statistician's guess than an amateur's estimate.—What information we have suggests that with the large concern which has an efficient pay roll procedure and a highly mechanised one, the staff cost on the employer is probably of the order of one clerk per 4,000 employees. In the case of the small concern where there is no mechanisation it may be as high as one clerk for 800 employees. If one took a figure of one clerk for

2,000 employees it would give a staff cost on industry as a whole of something of the order of 10,000 clerks, but whether the true figure is 10,000 or 15,000 I am not really in a position to say, but it is clearly of that order.

763. Thank you. I wanted to get a figure of some sort with all the qualifications that you give to it.—May I make it clear that if you introduce a scheme of the character you have been discussing you would not sweep away the whole of that work. There would still be a great deal which the employer would have to do and that means that his aggregate saving would only be some fraction of your starting figure of 10 or 15,000.

764. His saving would not be as great as the savings in Inland Revenue?—No.

765. Is there any notion of similar figures, perhaps Mr. Williams could answer this, in respect of National Insurance contributions?—Mr. Williams: I am afraid we have no information at all.

766. Would it be possible to arrive at what Mr. Cockfield called a guess, an informed guess?—Certainly not an informed guess.

767. Nor even an uninformed guess. Mr. Cockfield, on a different point altogether, would you say that it is true as a generalisation that the smaller average amount of tax per head collected in any group of taxpayers the larger the cost per pound collected?—That depends entirely on whether they are taxpayers of a like nature. For example I would not like to make any direct comparison between the cost of collecting small amounts under Schedule D and the cost of collecting small amounts under P.A.Y.E., but if one takes, say, P.A.Y.E. itself, the cost of collecting very small sums is obviously greater per pound collected than the cost of collecting very large sums. It takes almost as much effort to deal with the employee with £500 a year as it does to deal with the employee with £1,500 a year and obviously you get much more tax for your efforts out of the £1,500 a year than you do out of the £500 a year man.

768. The same, broadly, would apply to the person who is not an employee?—It would.

769. So that broadly speaking if one takes groups of like cases my generalisation would be true?—It is.

770. Is the progression steep?—I would not like to express any opinion on that, but I should imagine that if one takes, for example, P.A.Y.E. where the conditions are very similar for one employee and another, there would be what one might almost describe as standing charges for every man who comes into the system. If he has an income of £200, £300 or £500 you will have the same necessity for issuing the return form, computing the code number, notifying the employer and so forth.

771. Mr. Bullock: I suppose as a statistician you would say that every advantage in life has its corresponding disadvantage?—I think that is perhaps an expression of opinion which would not be confined to statisticians.

772. Are not all employers compelled to return the earnings of their employees?—They are and have been for a very long time.

773. How do you say, therefore, you have no knowledge of the earnings of people—in replying to a question just now?—I do not quite know what question you are referring to?

774. I thought Mr. Keldor was questioning you about the number below a certain level?—We are perfectly prepared to produce the most detailed figures giving the number of people in each income group and the amount of tax they pay. Those figures, indeed, are already published in our 52nd Report and in the annual White Paper on National Income and Expenditure. I am frightfully sorry if I gave the wrong impression on that.

775. You were talking about disincentives—but before I speak to you about that I was going to ask you whether the great virtue of P.A.Y.E. or as many factory workers say "Pay all you earn" is that it gets you the money much more easily with less work and with less bad debts?—Pay As You Earn was introduced following pressure from the ordinary taxpayer that he should be allowed to pay his tax currently out of his earnings. It was not introduced primarily as an administrative way of collecting tax. In 1940 we did introduce a scheme for collecting income tax in arrears on the basis of assessments actually

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748. Yes, I see.—Assuming of course, the man was under £600 a year.

749. Thank you, Mr. Cockfield. That answers all I want to know.

750. Mr. Carrington: The only question I want to ask is this. Have any attempts been made to simplify P.A.Y.E. since it was introduced in 1944 or 1945 and if so have those attempts been successful?—Yes, an enormous amount has been done in that direction. Perhaps I might quote one particular thing, namely the introduction of what started by being extra-statutory non-assessing and which subsequently became statutory non-assessing. Under the original scheme it was contemplated that at the end of the year an assessment would be raised on every single individual coming under P.A.Y.E. We came to the conclusion that this would impose upon the Department an impossible burden of work. In most instances the amount of tax involved was frightfully small and we did obtain the authority of the Chancellor not to raise assessments over a wide part of the field, and subsequently we were given statutory authority to do that. That has saved an immense amount of staff. There have been other devices which have been introduced. For example, when we started with P.A.Y.E. it was contemplated that when the allowances were altered in the Annual Budget, everybody would have to be re-coded. After a year or two we hit upon an ingenious device under which in most instances we can alter the value of the code number in the tables instead of altering the coding for the individual taxpayer; this has meant that when there have been Budget changes the amount of work involved has been very greatly reduced. It has always been our object throughout to try to streamline the procedure under P.A.Y.E. to the utmost extent.

751. Have you made any attempt, if so with what degree of success, to cut down the employer's work by simplifying the code tables and the literature published with the code tables?—I think the point there really is that the amount of work which is imposed on the employer under the present system is quite inevitable if you start from the point of view that you must collect tax during the year which is the right amount of the liability. You can ensure that you collect the right amount of tax by the end of the year without subsequent adjustment only if you have a cumulative system of the kind

that we have under P.A.Y.E., and if you ensure that when the man moves from one employer to another cumulation is continued. It is the position, however, that the larger employers have been able to introduce a very large measure of mechanisation in dealing with the tax deductions and to integrate them with their ordinary pay roll procedure.

752. Your tax tables though are simpler, are they not, than they were five years ago?—The tax tables are different from what they were five years ago, and the great merit of the new table is not that it imposes less work on the employer, it might indeed be held that it imposes more, but that it is very much smaller and if you have a change in the Budget which involves the production of new P.A.Y.E. tables you can do them very much more quickly than you could with the old type of very large table.

753. The old table was about the size of a London telephone directory, was it not?—It was considerably larger, because almost a complete shelf of my bookcase every year used to consist of a complete set of P.A.Y.E. tables, and I believe they contained about 30 million separate computations. But they did take about six months to produce, and it was felt by the Chancellor that it was quite impossible to have a time lag of six months between the date of introduction of a Budget and the date when changes of taxation were reflected in the pay packet. And, as you will have seen this year, we have succeeded in getting that time lag down to very reasonable proportions. The new tables this year were introduced on the 25th May following a Budget statement on the 10th April, and that is entirely due to the introduction of this new kind of table.

754. Mr. Hicks: I am not sure whether this is quite the right moment to introduce this, but the question which I should like to ask at this point is rather something of this kind. Supposing that the proposal which was under discussion was varied in this particular way: that instead of being asked what would happen if everybody was made liable to income tax in the sort of way that has been suggested, the proposal had been put in this form: that the income tax exemption limit should be raised so as to bring no larger a proportion of the total population liable to income tax than was the case, let us say, in 1938, that the present social insurance contribution should be abolished, but that in place of that contribution and at the lower end of income tax, a new tax should be introduced, or new contribution we might call it, which was to be on a more or less proportional basis, but the exact conditions of which—such as what income was to be liable to it, what exemption if any was to be given and so on—could be discussed *de novo*, discussed entirely from the point of view of what was the fairest system which could be brought about within that frontier in order to get a reasonably inexpensive system of collection and assessment. It would probably be the case, I imagine, that it would not be necessary, since the thing would be quite separate from the ordinary income tax, to give some of the more elaborate concessions in such a tax as are given in the ordinary income tax. The fact that it would be a substitution for the definitely less carefully adjusted arrangement of the post-tax contribution would mean that you could afford, you would be securing, a greater degree of fairness, even if you were rather rougher than you were in the ordinary income tax. Have you given any thought as to what possibilities there are in that type of arrangement?—This is of course a very interesting suggestion. As I understand it what you propose is that the existing income tax should be confined to what I might describe as the middle and upper income groups, and that the low groups should be subjected to an entirely new tax of a much simpler kind.

755. Yes?—I think all I can say at this stage is that if one introduced a new tax of that character it would probably have quite considerable advantages in some directions but you would almost certainly have disadvantages in others, and the problem which one is faced with is weighing the advantages against the disadvantages to see whether on balance the scheme was an improvement on the existing one or not. One would like to see a scheme of that sort in rather more detail before committing oneself to what in fact the advantages or disadvantages were.

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Mr. G. M. WILLIAMS, C.B.E. AND Mr. R. U. L. EDWARDS

[Continued]

754. Mr. Kaldor: I want to ask Mr. Cockfield, rather thinking on the same lines as Mr. Hicks, instead of pursuing for the moment the question of what would happen if you bring everybody into income tax, what would happen if you reduced a number of people now liable to tax. Incidentally in your figures in paragraph 35 of the Inland Revenue Memorandum you mention that there are 19 million people with earned incomes below £600 but above the exemption limit of £135 a year. Of these at present six million pay nothing at all. In addition I take it there may be about three million people, roughly speaking, who have earned incomes under £135 a year. Would that be correct?—We have no precise information ourselves about people whose incomes are below the income tax exemption limit, but a comparison of our figures with what other data is available suggests that there are several million people with earned incomes below the income tax exemption limit. Whether the figure is precisely three or rather different I am not in a position to say, but obviously three is not far wrong.

757. So the Liberal Party scheme or Lady Rhys Williams's scheme would bring in nine million additional people to income tax?—It might well do so.

758. You say four million people pay only 2s. in the pound at present and a further eight and a quarter million pay 4s. in the pound. Have you any figures of how much money they bring in, the four million people who pay only 2s. in the pound?—We can supply you with such information. The total amount of course paid by the people paying at 2s. is obviously very small because their average taxable income will be, say, just under £25. Their tax bill therefore, on average, is about £2 10s. a year and four million of them therefore would pay in the aggregate £10 million.

759. Could you net this figure if you take the administrative costs involved in collecting £10 million from four million people?—The cost is obviously very small. The total cost of running the Inland Revenue Department is only between £20 and £30 million, and that covers all our 21 million customers, some of whom, of course, are very large companies where the amount of work on the accounts may be very substantial indeed. The cost per head for the small taxpayers is very small.

760. Yes, I see. And you have not any figures to show, if the exemption limit were reduced so as to put it beyond most if not all wage earners and then abolished P.A.Y.E., what sort of loss that would imply in smaller revenue?—There is a very difficult technical problem there if I may put it, and that is this: suppose you raise the effective exemption limit for the married couple so that it becomes £500 instead of being £225 with Earned Income Relief as it was in 1950-51; it is admittedly true that the tax paid by the people below £500 who would then be exempted from tax may not be very substantial, but you cannot exempt the man earning £499 altogether from his tax and continue to charge the man whose income is £501 the existing tax bill which may amount to a fairly substantial amount. One must therefore, as it were, taper off the relief above £500. If one does this by the simplest method which is a very big lift in the personal allowances, the aggregate cost of it runs into several hundreds of million pounds, not because of what you give to the people below £500 but because of what you give to the people above £500.

761. Mr. Crick: In paragraph 39 of your document there appears this passage—after stating your manpower savings in Inland Revenue: "There would also be a considerable saving in industry but we are not in a position to quantify this." Was any attempt made when P.A.Y.E. was introduced to guess at the burden in terms of manpower that this scheme was to impose upon employers?—Well, Sir, if it is guesswork which you are content with, I am perfectly prepared to make some current guesses, but I ought quite frankly to say that we have not the information on which to make an estimate which I would be prepared to support as being entirely accurate.

762. I would far rather have a statistician's guess than an amateur's estimate.—What information we have suggests that with the large concern which has an efficient pay roll procedure and a highly mechanised one, the staff cost on the employer is probably of the order of one clerk per 4,000 employees. In the case of the small concern where there is no mechanisation it may be as high as one clerk for 800 employees. If one took a figure of one clerk for

2,000 employees it would give a stiff cost on industry as a whole of something of the order of 10,000 clerks, but whether the true figure is 10,000 or 15,000 I am not really in a position to say, but it is clearly of that order.

763. Thank you. I wanted to get a figure of some sort with all the qualifications that you give to it—May I make it clear that if you introduce a scheme of the character you have been discussing you would not sweep away the whole of that work. There would still be a great deal which the employer would have to do and that means that his aggregate saving would only be some fraction of your starting figure of 10 or 15,000.

764. His saving would not be as great as the savings in Inland Revenue?—No.

765. Is there any notion of similar figures, perhaps Mr. Williams could answer this, in respect of National Insurance contributions?—Mr. Williams: I am afraid we have no information at all.

766. Would it be possible to arrive at what Mr. Cockfield called a guess, an informed guess?—Certainly not an informed guess.

767. Not even an uninformed guess. Mr. Cockfield, on a different point altogether, would you say that it is true as a generalisation that the smaller average amount of tax per head collected in any group of taxpayers the larger the cost per pound collected?—That depends entirely on whether they are taxpayers of a like nature. For example I would not like to make any direct comparison between the cost of collecting small amounts under Schedule D and the cost of collecting small amounts under P.A.Y.E., but if one takes, say, P.A.Y.E. itself, the cost of collecting very small sums is obviously greater per pound collected than the cost of collecting very large sums. It takes almost as much effort to deal with the employee with £500 a year as it does to deal with the employee with £1,500 a year and obviously you get much more tax for your efforts out of the £1,500 a year than you do out of the £500 a year man.

768. The same, broadly, would apply to the person who is not an employee?—It would.

769. So that broadly speaking if one takes groups of like cases my generalisation would be true?—It is.

770. Is the progression steep?—I would not like to express any opinion on that, but I should imagine that if one takes, for example, P.A.Y.E. where the conditions are very similar for one employee and another, there would be what one might almost describe as standing charges for every man who comes into the system. If he has an income of £200, £300 or £500 you still have the same necessity for issuing the return form, computing the code number, notifying the employer and so forth.

771. Mr. Bullock: I suppose as a statistician you would say that every advantage in life has its corresponding disadvantage?—I think that is perhaps an expression of opinion which would not be confined to statisticians.

772. Are not all employers compelled to return the earnings of their employees?—They are and have been for a very long time.

773. How do you say, therefore, you have no knowledge of the earnings of people—in replying to a question just now?—I do not quite know what question you are referring to?

774. I thought Mr. Kaldor was questioning you about the number below a certain level?—We are perfectly prepared to produce the most detailed figures giving the number of people in each income group and the amount of tax they pay. Those figures, indeed, are already published in our 92nd Report and in the annual White Paper on National Income and Expenditure. I am frightfully sorry if I gave the wrong impression on that.

775. You were talking about disincentives—then before I speak to you about that I was going to ask you whether the great virtue of P.A.Y.E., or as many factory workers say "Pay all you earn" is that it gets you the money much more easily with less work and with less bad debts?—Pay As You Earn was introduced following pressure from the ordinary taxpayer that he should be allowed to pay his tax currently out of his earnings. It was not introduced primarily as an administrative way of collecting tax. In 1940 we did introduce a scheme for collecting income tax in arrears on the basis of assessments actually

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[Continued]

made. There was a great deal of agitation on the point that because the tax was collected in arrears if the earnings fell there might be great hardship, and it was represented that it would be much more satisfactory if the tax could be collected from the earnings when they were earned so that the high earnings bore the high tax and the low earnings bore the low tax, and at the end of the year the man was straight with the Inland Revenue. He had discharged his tax and there was no question of his having a large tax bill hanging over his head in the event of unemployment, sickness or retirement.

776. I know that the greatest disincentive of course, is the tax itself, but do you not think it would be much better for the average taxpayer who is paying under P.A.Y.E. if, on that slip that you send him showing what his code number is, it was put explicitly what the income was and what the tax would be likely to be upon certain revisions one way or the other throughout the year. The thing seems to be shadowed in mystery from the point of view of the average factory worker and causes quite a good deal of discontent?—My own impression was that the average worker understood the operations of P.A.Y.E. rather clearly and of course tax tables are available in all large works. They are in the hands of the Trade Unions and they may also be consulted in public libraries for people to check their tax deductions if they so desire.

777. I would not know much about Trade Unions, but I was going to ask you one other question. In considering disincentives is not the greatest disincentive the fact that the employer is the vehicle through which the cut in the man's wages takes place and that causes quite a good deal of trouble among men generally wherever they congregate and talk about these matters?—But does that not arise essentially from the fact that in these days you do collect a substantial amount of tax from people and it is the tax which they have to pay which causes the pinch of the shoe. The only alternative to some system of collection from wages currently is a system of direct collection from the man at the end of the year and with taxes at their present rates it would be quite impossible to come along at the end of the year and ask the ordinary working man to pay £40, £50 or £60 tax in one sum.

778. *Sir Harry Gill:* I have only one question. Whenever disincentives have been referred to you have always stressed the position that there are, I think, six million workers not subject to tax?—Yes.

779. Will not a great number of that six million be what might be termed borderline cases?—There are obviously some of them whose total income is not far short of the point at which they would be liable to tax.

780. I think there must be a considerable number; I am of the opinion that those borderline cases are more concerned about their income tax position and not getting gathered into the net than anyone else, and that it is those people who will think out ways and means not to be caught in the income tax net.—This is, if I may say so, largely a matter of opinion upon which very little factual information one way or another is available, but I would point out that these figures are, if I may use a technical term, *ex-post* and not *ex-ante*. You are in effect looking at what happened by the end of the year, and if the man has paid no tax by the end of the year he could not have been deterred by the tax, and therefore the figure of his income must include any overtime he worked.

781. Yes. If in the borderline cases he wakes that, he does not work that extra time, but as you say that is a matter of opinion. I merely want to bring out the fact that it is not quite right to rule out all those six million as not being affected.—The point we were making, if I may say so, is that under the present system virtually all the 19 million people below £600 a year would pay less tax than they would under the Liberal Party scheme where the rate of tax proposed is 5s., and that point is equally valid whether the man is in the income group which produces no liability at all or whether he is in the lowest taxable group, where, for 1950-51, the effective rate of tax on earned income is only 2s. in the pound.

Chairman: We are very much obliged to you and your colleagues for coming here this afternoon. We may want some further assistance but that is all we have to ask you for the moment.

The witnesses withdrew.

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MINUTES OF EVIDENCE

TAKEN BEFORE THE

4

ROYAL COMMISSION ON
THE TAXATION OF
PROFITS AND INCOME



FOURTH DAY

Thursday, 1st November, 1951

WITNESSES

MR. S. P. CHAMBERS, C.B., C.I.E.
MR. C. D. HELLYAR
MR. A. G. DAVIES

} The Federation of British Industries. *Questions 782-1095*



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TERMS OF REFERENCE

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages: to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer: to consider the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden fairly among the individual members of the community: and to make recommendations consistent with maintaining the same total yield of the existing duties in relation to the national income."

NOTE

For the guidance of intending witnesses the Commission published a list of the main heads under which evidence was invited. They explained that the list was not necessarily exhaustive and that witnesses could put in evidence on questions not specifically mentioned, provided that they fell within the Commission's terms of reference. The list is reproduced below.

A. General social and economic questions

1. Is the present system of taxation satisfactory, or could it be improved, in relation to:—
 - (a) incentives,
 - (b) risk bearing,
 - (c) encouraging savings,
 - (d) the control of inflationary or deflationary tendencies,
 - (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment,
 - (f) its effect on the distribution of personal incomes,
 - (g) other economic and social objectives?

These questions can be considered in relation to the taxation of:—

- (i) salaries and wages (P.A.Y.E.),
- (ii) profits of businesses and self-employments,
- (iii) dividends and other sources of income.

2. Would it be advantageous to link Income Tax with social security payments and contributions?
3. Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

B. Particular matters

4. Is the taxation not drawn too widely or too narrowly in relation to:—
 - (a) the taxation of United Kingdom residents (companies or individuals) on overseas profits,
 - (b) the taxation of non-residents on United Kingdom profits,
 - (c) the definition of residence, etc.?
5. (a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particular—
 - (b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?
6. Is the basis of computing income from property under Schedules A and B satisfactory?
7. Should the present rules about deductions for outgoings and expenses be altered?
8. Are the provisions for relief in respect of double taxation satisfactory?
9. Should the present system of graduation by means of the exemption limit, personal allowances, reduced rate relief and Surtax be altered?
10. Should the existing differentiation between earned and unearned income be extended or reduced?
11. Are alterations necessary in the rules governing personal and other allowances?
12. Should the rules about the taxation of husband and wife be altered (a) as regards aggregation; (b) in any other respect?
13. Should P.A.Y.E. be altered or abolished?
14. Should the principle of deduction at source be extended or restricted?
15. Should the method of assessment to Surtax be altered, and in particular should it be deducted from salaries?
16. Are any alterations desirable in the system of administration and the functions of the various statutory bodies or persons connected with taxation?
17. Are any changes in the provisions against avoidance and evasion desirable?
18. Is any alteration necessary in the rules governing the taxation treatment of special classes of taxpayers (e.g., public corporations, co-operative societies, charities)?

MINUTES OF EVIDENCE TAKEN BEFORE THE ROYAL COMMISSION ON THE TAXATION OF PROFITS AND INCOME

FOURTH DAY

Thursday, 1st November, 1951

PRESENT:

The Rt. Hon. LORD JUSTICE COHEN (*Chairman*)

Mrs. VERA ARSTY, D.Sc.*

Mr. H. L. BULLOCK*

Mr. W. S. CARRINGTON, F.C.A.

Mr. W. F. CRICK

Sir HARRY GILL, J.P.

Mr. J. E. GREENWOOD

Sir GREGORY HEYWORTH

Mr. J. R. HICKS, F.R.A.*

Mr. N. KALDER

Mr. W. J. KIRKWOOD

Mr. J. MOLLARD TUCKER, K.C.

Mr. E. R. BROOKES (*Secretary*)

Mr. D. G. DAYMOND (*Assistant Secretary*)

* Present during the morning only.

Mr. S. P. CHAMBERS, C.B., C.I.E., Mr. C. D. HILATYAR and Mr. A. G. DAVIES, on behalf of the Federation of British Industries; called and examined.

MEMORANDUM SUBMITTED BY THE FEDERATION OF BRITISH INDUSTRIES

Note: In accordance with the wishes expressed by the Royal Commission the Federation has divided the written evidence which it wishes to submit into two parts and has followed the headings suggested in the notice issued on behalf of the Royal Commission. This memorandum deals only with Part A ("General social and economic questions"); a second memorandum dealing with Part B ("Particular matters") will be submitted later.

PART A. GENERAL SOCIAL AND ECONOMIC QUESTIONS

Section 1

Is the present system of taxation satisfactory, or could it be improved, in relation to:

- (a) incentives,
- (b) risk bearing,
- (c) encouraging savings,
- (d) the control of inflationary or deflationary tendencies,
- (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment,
- (f) its effect on the distribution of personal income,
- (g) other economic and social objectives?

These questions are considered in relation to the taxation of:

- (i) salaries and wages,
- (ii) profits of businesses and self-employments,
- (iii) dividends and other sources of income.

The burden of taxation as a whole

1. The terms of reference restrict the Royal Commission to an inquiry into "the taxation of profits and income" and require the Royal Commission "to make recommendations consistent with maintaining the same total yield of the existing duties in relation to the national income". The use of these words, it is assumed, precludes any consideration by the Royal Commission of either the general economic and social effects of the burden of taxation as a whole, including indirect taxation, or of the division of the tax burden between the direct taxes which fall directly upon profits and other forms of income and the indirect taxes, such as customs duties, excise duties, and purchase tax which cannot be considered as falling under the heading of "the taxation of profits and income".

2. It is the opinion of the Federation that these limitations are very regrettable because the main trouble with the present burden of taxation in its effect upon incentives, risk bearing, savings and the control of inflationary tendencies lies in the total weight of the burden. While some improvements can be effected the Federation does not believe that improvements in either the incidence of the tax or in the machinery of assessment and collection can remedy the present evils which spring from the weight of taxation as a whole, a consideration of which is altogether more important than any consideration of particular aspects of any part of that burden.

3. The principles upon which taxation is levied upon income are not independent of the level of taxation. What is appropriate and sound for taxation which takes only 5 per cent. or 10 per cent. of the national income may be inappropriate and unsound when the burden amounts to 30 per cent. or 40 per cent. of the national income. Rules for the determination of income or profits which are accurate enough for the smaller tax burden become anomalous when applied to the higher burden. This is particularly true in its application to the taxation of profits. The inadequacy or absence of any deduction for the depreciation of certain classes of assets may be tolerable when the rates of tax are low and may be offset by other imperfections in the determination of income, but when the rates are high they materially affect the incidence of tax between one class of business and another and may make the effective rate of taxation substantially higher than the nominal rates. Similar considerations apply to the determination of the dividing line between income and capital or that between income which is taxable and income, such as certain forms of income is kind, which is not taxable. For these reasons the standard of accuracy in the determination of income which was acceptable when the Royal Commission on the Income Tax considered the matter in 1920 is no longer appropriate and does not produce equitable results today. Other anomalies arise through the inter-action of different taxes, e.g., income tax and estate duty, and reach serious proportions when the rates of both taxes are high. This question of considering taxation principles and practices not only in the abstract but in relation to the level of taxation recurs in the paragraphs below which deal with different aspects of the subject.

The Taxation of Salaries and Wages

4. The essential features of the existing system of taxation of wages and salaries are the same as for other forms of earned income. There is a limit, dependent

upon the circumstances of the individual, up to which the income is exempt: above this limit and up to a further £50 tax is charged at the lowest rate of 2s. 6d. taking the earned income allowance into account; above that and up to a further £200 the charge is 4s. 6d.; above that again and up to the level of £2,000 total earned income the rate is 7s. 7d. Thereafter the full standard rate of 9s. 6d. plus surtax comes into operation.

5. It follows inevitably from our system where the rate of tax itself increases with increasing income that the average rate—the taxpayer's effective rate on his total income—can be substantially less than the marginal rate on the top £1 of income.

6. P.A.Y.E. is no more than machinery for the collection of income tax on earnings on the basis of the current year. It operates automatically and immediately to apply to the periodic remuneration the rate of tax which is appropriate having regard to the income which has accrued since the beginning of the year of assessment and to the proportion of allowances which has accrued. It can happen, therefore, that, for a particular pay period where there has been an effort expended above the normal so that the earnings are exceptional, a rate of tax will be applied which is above the true average for the year. This tends to lead to misunderstanding of the real position by the employee.

As is the case with any psychological considerations, the precise effect of such misunderstanding is difficult to evaluate. It may be that P.A.Y.E. has now been in operation long enough for large numbers of people to realise that the "excessive" deduction will be compensated subsequently during the year and that the true average will ultimately emerge. It may also be that the number of individuals adversely affected by these considerations is a diminishing proportion of the total.

7. Under the system of tax deduction in force for a short time immediately before the introduction of P.A.Y.E. the tax deduction was fixed in advance by reference to an assessment based upon past earnings. The tax deduction under that system was fixed for each week (or month) for a period of six months and did not vary with current earnings. As a consequence extra earnings for extra work in any week did not attract extra tax in that week. A system under which deductions are fixed in advance and unvarying for a substantial period does not reveal so readily the progressive character of the tax and for that reason may have a smaller effect upon the will to do extra work for extra pay. This fact was known when P.A.Y.E. was introduced but the inequity and the handicaps inherent in the previous system, or in direct collection upon an assessment made upon past earnings, were deemed to outweigh this feature of P.A.Y.E. which, by relating the amount of the tax deduction to the earnings from which the deduction is made, is demonstrably more equitable and less likely to lead to hardship.

8. While agreeing that there is possibly some effect arising from the operation of P.A.Y.E. which might tend to discourage production, the Federation discounts the argument that P.A.Y.E. itself furnishes a major disincentive, and, while reserving the right to put forward comments and suggestions at a later stage in connection with the more detailed matters to be considered, it is inclined to the view that the principle of tax deduction at source on a current earnings basis should be retained.

9. Real disincentive does arise from the weight of tax and its progressive nature. The average employee does understand, although in some cases perhaps only vaguely, that as his remuneration passes certain levels per annum the income above those levels moves into a different category as far as the rates of tax applicable are concerned. The remuneration becomes progressively less attractive and the effort expended appears less worthwhile. It is difficult to demonstrate factually to what extent this effect operates; the problem of incentive is complex since it is related so closely to conventional standards of living and to the availability of consumer goods to satisfy additional purchasing power produced by extra earnings. In principle it seems elementary that people will not work just as hard for lower net earnings as they will for higher net earnings. It can, of course, be argued that, on the contrary, if the individual's own income is cut down in relation to his wants by reason of taxation, he will work harder to supply the deficiency;

but with oppressively high rates of tax this is not easy, and in any event the argument is one which would apply with force only if there were real necessity to make up the deficiency, that is to say if the necessities or necessities of life would otherwise be unobtainable.

10. Evidence of this effect upon industrial workers is given in the Reports of the productivity teams sponsored by the Anglo-American Productivity Council. There can be little doubt that the difference between the attitude of workers in the two countries is attributable, at least in part, to the policy of providing security, free health and medical services, controlled rents and subsidised food, coupled with a steeply graduated tax structure which throws the main burden of both direct and indirect tax upon marginal income.

11. The discouraging effect of the steeply rising rate of tax, accentuated by the abrupt changes in the marginal rate as different levels of income are reached, extends to all incomes once the exemption range is passed, although here again it must be recognised that this accumulation is secondary and arises out of the system under which the progressive rates of taxation come into effect. The burden is felt more in the lowest stages when over a short range of income the marginal rate rises in steps from nil to 7s. 7d. There is then a relatively extensive "plateau" and until the level of £2,000 per annum is reached the marginal rate remains at 7s. 7d. although the average rate steadily increases as a greater proportion of income attracts the higher rate appropriate to the "plateau". Throughout this stage, although there is the obviously discouraging effect of the heavy taxation of the earnings, the additional discouragement arising from the penalty of an increased rate of tax on increased earnings is missing, and for this reason it is probably right to say that throughout this range the disincentive effect is somewhat less marked.

12. When the £2,000 level is passed those effects which operate at the lowest levels make themselves felt again and with special force. No earned income allowance is given on further earnings and surtax at 2s. is levied. The marginal rate thus leaps from 7s. 7d. in the £ to 11s. 6d. After £2,500 it is stepped up to 12s. and thereafter by rapid stages until the net marginal income after taxation is negligible compared with the attractions of leisure. The Federation lays emphasis on the effect upon higher earnings and expresses the view that the rate of tax is a greater deterrent to effort in those ranges where it is impossible to obtain a reward in any way commensurate with the time and labour expended than it is in the lower ranges of income.

13. It is not possible to reward good work in management in any way which does not result in the greater part of the reward reaching the State in taxation. The standard of living of the outstanding man cannot be very different from that of the mediocre. In the higher classes of the Civil Service, in the professions and in the Arts there are other rewards for outstanding achievement, but in industry the reward must inevitably be mainly in the form of money income and this has been very largely removed by the high marginal rates of income tax including surtax. With the fall in the value of money, the maintenance of a surtax exemption limit of £2,000 means that the tax starts at a lower level of real income than it did before the war and the tax burden is correspondingly greater.

14. In this respect the rewards to be gained in the United States, in Continental Europe, or indeed practically anywhere else in the world, are much greater than those to be gained in this country. If the spirit of enterprise and concentrated endeavour in industrial management should appear to be more noticeable in these countries, this cannot be wholly unconnected with the much higher marginal rates of taxation in this country. The long term effect must also be emphasised. If the situation continues that, to young men of character and ability, endeavour in this country does not offer the same rewards as in others, then the spirit of enterprise which has been characteristic of British industry for so long must inevitably suffer.

15. In the view of the Federation, short of a substantial reduction in the level of taxation as a whole the removal of the worst effects of income tax upon the incentives to work can be achieved only by a fundamental change in the tax structure itself which reduces the gap between the average rate of tax upon the wage or salary and the marginal rate of tax upon the top slice of that wage or salary.

16. In some other countries this problem has been tackled in one of two ways. Either extra earnings, including overtime pay, have been taxed at the average rate appropriate to the income before the addition of these extra earnings, or wages as a whole are excluded from the general income tax and subjected to a special wages tax. The British system of personal allowances and graduated rates does not lend itself readily to the first of these courses, but this question could be reconsidered if a relevant change in the system were contemplated. The second course, to exclude wages from income tax and to levy a special wages tax, is inappropriate to the British system; as the defect is inherent in the tax rates, the solution should be operative for all income subject to tax and at all levels of income. All income should be charged to tax in the same manner irrespective of its nature.

17. Any solution of the problems arising from the graduation of the tax must, it is considered, be applicable to incomes of all kinds within the same income brackets. This subject is taken up again in Section 2 which deals with the links between Income Tax and the Social Security payments and contributions.

18. The relationship between savings and the taxation of wages and salaries has undergone an important transformation during the past two or three decades. The old emphasis upon thrift, saving for a "rainy day", unemployment, ill-health, old age or early death which might leave dependants in grave distress, has gone. Today much of the saving is compulsory, mainly through the National Contributions deducted from all salaries and wages, and much of the need to save has disappeared as the State has assumed the responsibility for the relief of the worst of the economic distress caused by unemployment, ill-health, old age, or early death. For large numbers of employees pension schemes, which add materially to State benefits, have assumed an importance which could hardly have been foreseen twenty or thirty years ago. As a consequence, the need for personal saving has declined at a time when heavier taxation has made saving more difficult. So far as wage-earners are concerned the rise in the cost of homebuilding, coupled with rent-restriction and with the subsidisation of local authority schemes for building houses to rent, has led to a decline in the need for saving for the purpose of building or buying houses. For salaried employees, the purchase of a house remains one of the principal objects of saving and the normal method of purchase on mortgage and the subsequent repayment of the loan out of current income is the principal method employed. In the case of many salaried employees, however, especially in the younger ranges, this object is so unattainable that hope is abandoned and thus for a different reason these salaried employees fall into the same category as the wage-earner who does not need to buy. Another method of saving is by means of life assurance policies. There is special tax relief for this method of saving and it can hardly be doubted that taxation has had an important influence in directing savings to this channel.

19. The older ambition of saving sufficient out of current wages or salary to become the owner of business seems to have declined and with it some of the keen interest in the prosperity of the particular business in which the wage-earner or salary earner is employed. In Britain the employee is, on the whole, content to be an employee for the rest of his life. In the United States the outlook is different, many wage or salary earners looking forward to the time when they own businesses themselves.

20. So far as the larger salaried incomes are concerned it is not perhaps sufficiently realised that the higher rates of income tax and surtax render it impossible today for businesses to be started and developed in the way which was typical in Britain in the nineteenth century. High rates of taxation which make it difficult to start a new business with personal capital tend to prejudice the setting up of new businesses and to restrict business enterprise to existing businesses and businesses owned by joint stock companies. They are also a contributing factor to the greater concentration of industry in large undertakings.

21. Another feature of the present system of heavy taxation of wages and salaries coupled with the assumption of responsibility by the State for education and the relief of unemployment, sickness, old age and early death, is that as the savings of the wage-earning and the salaried classes are now mainly compulsory or quasi-compulsory

(through a pension fund) these savings are largely concentrated in the hands of the State, where they are not always treated as savings, and in the big financial institutions such as insurance companies and pension funds. Each of the pension funds of the larger industrial organisations has a capital running into millions of pounds and these institutions are today an important section of the investing public. Savings made through these channels are different in character from personal savings and are not so readily available for the development of small businesses as for large. In so far as savings are discouraged, investigation would be necessary to determine whether the savings through institutions or through the State more than offset the reduction in voluntary personal savings.

22. Wage and salary earners constitute by far the largest group of taxpayers and easily outnumber all the others together. It is reasonable to assume, therefore, that the influence of taxation upon the willingness of these classes to work and to save is important. The effect upon their willingness to work has already been dealt with; in so far as they are discouraged from working hard and improving productivity the influence is inflationary because it reduces the total production available for consumption, export or capital. This influence is likely to be of a long-term character and, although important, it is rather imperceptible. Beyond a certain point heavy taxation to cut down consumption becomes self-destructive if it discourages production. It is probable that this point has been reached or passed in Britain today.

23. Similar considerations apply to the effect of the present taxation of wages and salaries upon the balance of payments. If productivity has been weakened and costs have risen in consequence the ability to compete in overseas markets is weakened. There is then the danger that devaluation of the currency to encourage export leads to higher cost of living, lower real wage incomes and further discouragement of hard work. A downward spiral of this kind is quite possible and would be consistent with inflationary conditions due to the excessive taxation of the main body of consumers.

24. In the view of the Federation, therefore, the outstanding defect in the present taxation of salaries and wages lies in the discrepancy between the average rate and the marginal rate which is seriously aggravated by the high level of taxation. It would be easier to effect radical changes in the tax structure if these were carried out in conjunction with a reduction in the level of taxation.

Profit of Businesses and Self-Employments

25. It is convenient to divide businesses into two groups (a) those owned by limited liability companies and (b) those owned by private individuals or firms. Self-employments can, for convenience, be included in the second group. In the following paragraphs considerations which are common to both classes are dealt with first, then problems concerning the second group. Considerations peculiar to companies are dealt with in Section 3 of this memorandum.

26. A memorandum was submitted by the Federation to the Committee which sat under the Chairmanship of Mr. Millard Tucker, K.C., to consider the computation of profits for tax purposes,* and it is assumed that the contents of that memorandum are before the Royal Commission. Only certain wider implications of the imperfect determination of profit are dealt with here.

27. Where the taxation measure of profit differs substantially from what the economist would consider to be the true profit the effective rate of tax will vary from the nominal rate imposed in the Statute. When rates of taxation were of the order of 5 per cent. this inequality, though timeous, was relatively unimportant; now that profits tax and income tax at the standard rate exceed 30 per cent. in the case of a company and income tax (including sur-tax) in the case of a privately-owned business can reach 97½ per cent. at the margin, the effect of arbitrary rules can be quite devastating. If a 5 per cent. nominal rate becomes 10 per cent. because the true profit is only half the profit according to the tax law, there is still 90 per cent. of the income left instead of 95 per cent. But if the effective rate is 100 per cent. instead of 30 per cent. or if the tax bill exceeds the real income, there is grave hardship. Alternatively, if the effective rate is 25 per cent. instead of 50 per cent., there is an un-compensated advantage which is unfair to the main body of

* The Committee on the Taxation of Trading Profits. Cmd. 5139

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social security payments and contributions is unsound, there remains the possibility of associating the two systems for the purposes of administration. The present system of income tax allowances imposes a heavy administrative burden both upon industry and upon the Inland Revenue Authorities. It may also be that the time has come when that system should be revised with a view to achieving economy of administration.

52. If after further consideration the Federation should have any proposals to advance, particularly in connection with the revision of the system of tax allowances, these will be included in the second memorandum to be submitted.

Section 3

Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

53. In such matters as the computation of profits and the basis of assessment there are many problems common to companies and to other taxpayers assessable to income tax and there are some problems peculiar to companies. On these matters, however, the Federation has made representations to the Tucker Committee and no further reference is necessary here.

EXAMINATION OF WITNESSES

782. *Chairman:* We always begin by asking representatives of any body who come and give evidence before us whether they wish to supplement the memorandum they have put in before we begin to ask questions. Is there any statement you or your colleagues wish to make?—*Mr. Chambers:* No, Sir. I think the evidence in the document plus what we said to Mr. Tucker's Committee contains all we wish to say in respect of this part of the proceedings.

783. You must not assume that we have all read everything you have put in for Mr. Tucker's Committee, otherwise there would be no point in having a previous committee. We have seen what conclusions they have come to and we are naturally going to exercise our own judgment on those conclusions, but I do not want you to labour under the impression that we have all read your representations to the Committee. Where you expressly refer to any paragraph in it, no doubt we have looked at it?—*May I say on that, that we did receive a circular which read as follows on this point:—*

"Evidence supplied to either of the two Committees presided over by Mr. J. Millard Tucker will be available to the Commission and need not be repeated." That was specifically told us.

784. That is true, but if there is any part of it which in view of the Tucker Report you want us to look at again, you must call our attention to it, otherwise I do not suppose we shall all read all of it?—*Certainly.*

785. I shall put my questions all to you, but if you want any of your colleagues to answer any particular question that of course is a matter entirely for you. The first thing I notice is that all the three bodies who are coming to give evidence this week, the Federation of British Industries, the Association of British Chambers of Commerce and the National Union of Manufacturers, agree that the main evil is the weight of tax, but you no doubt appreciate that our terms of reference prohibit our recommending immediate reductions unless we can find other sources of revenue from a tax on profits or income to make good the cost of any reduction that we may recommend. Have you any suggestions as to other forms of tax on profits or income which will provide revenue from which we can grant some of the reductions you press for?—*No, Sir. I think we very much appreciate that the terms of reference are indeed as you have expressed them and could hardly have been otherwise unless the Commission were asked to take over the functions of the Chancellor. We have not directed our attention to this point because the view of the Federation is of course that the weight of taxation itself is too high and that some of the evils to which we refer can only be overcome if the taxation of profits and income as a*

54. So far as the Profits Tax is concerned the Federation has consistently held the view that there is no justification of any kind for the discrimination against companies which this tax represents. The tax is imposed in addition to income tax and is a deduction in arriving at the profit chargeable to income tax. This double-layered taxation of corporate profits has the effect of obscuring the true rate of taxation upon those profits which is, of course, a higher rate than either the income tax rate or the Profits Tax rate taken separately.

55. As explained in paragraph 39, the Profits Tax cannot be deducted from dividends under the present law, and as it is computed by reference to the profit before deducting either preference or ordinary dividends, it results in a disproportionate burden upon company reserves and upon ordinary shareholders, particularly those with small incomes. This weighting of the scales against risk-taking is socially undesirable and the only remedy is the abolition of the tax.

56. Other matters falling within the field of the taxation of companies are of a more particular character, and insofar as they have not been referred to already in this memorandum or in the memorandum to the Tucker Committee they will be dealt with in the memorandum on Part B (particular matters) which will be submitted to the Royal Commission at a later date.

Whole is reduced; therefore in pressing for certain adjustments we have had in mind less the immediate effect on the revenue, but the making of the taxation more equitable, even if that involves, having taken these points into account, an adjustment by the Chancellor of the rates of tax that are imposed.

786. I follow. The manifestoes of the two Parties seem to indicate that they have already reached a conclusion on the subject we are considering. The Conservatives are pledged to a form of excess profits tax, and the Labour Party, had they been in office, would have found themselves pledged to a capital gains tax. First of all as to excess profits tax; would you welcome such a tax if the revenue from it provided some remission of either income tax or profits tax?—*If the excess profits tax were a tax at the rate that was charged during the war, a rate of 100 per cent, I think we would say definitely that that would be a bad tax from all points of view.*

787. Worse than the existing profits tax?—*I think at that rate it would be worse than the existing profits tax. We have maintained always that both taxes are bad, it is a question of saying which is the worse tax, but I think we would be inclined to agree that if a case could be made out that there were excessive profits, fortuitous profits, which arose solely as a result of a special re-armament drive, and if that element of excessive profits which was not due to the efforts of industry or of particular branches of industry could be segregated, and if it could be entirely distinguished from profits which are due to inflation, profits which we would regard as not true excess profits, then the taxation of that in place of the profits tax or part of the profits tax might well be a matter for consideration.*

788. It sounds rather a big "if," does it not? I will tell you why I put that question to you. One of the results of re-armament is to increase wages, I do not mean individual wages, but wages as a whole available in a certain branch of business. The working men who get those wages may have more to spend. They spend that money, we will say, in some chain stores, and the profit of the chain stores goes up. Would that be, for the purpose of your observation, a fortuitous gain which ought to be taxed? How do you draw the line?—*I was not suggesting one should attempt to segregate the profits of any armament industry. We would regard that as bad. If we could segregate that part of excess profits which was due to the fact that there has been a demand for goods in general, or the goods of manufacturing industries in general, in excess of what would otherwise be normal, and you can eliminate every part of that total profit which is due to the inclusion of an inflationary element, we would say that was a better subject for taxation; but we would not wish to segregate that profit, or attempt to distinguish profits which arise directly from re-armament from any other profits.*

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789. It is very difficult to consider this kind of subject in the air. I am afraid before that Commission finishes its deliberations probably some more concrete proposals will have emerged from the Chancellor next year, and it may be that your Federation will want to put in a further memorandum dealing with excess profits tax when that has taken place; before we report I daresay it will be part of the existing system of taxation.—We would very much welcome the opportunity of doing so if there is something concrete upon which we can make comment.

790. Now I would like to ask you about a capital gains tax. Here again we have no details of what the Labour Party had in mind, but supposing something on the lines of the American capital gains tax were proposed, would you think such a tax worth adopting, again if it made possible the adoption of some of the proposals of the Tucker Report which obviously involve a loss of revenue?—My Federation has not itself considered in detail the capital gains tax because that has not been a specific proposal before us, but the view we have taken in the past is that that tax is a bad tax for two reasons. One is that, during a period of rising prices in particular, what is regarded as a capital gain is not a true capital gain; it is frequently nothing more than an increase in the money value of capital which, from the economist's point of view, would not be regarded as a altered capital.

791. That I suppose applies also to profits other than capital profits?—It does, and so far as other profits do emerge as true income then it becomes taxable as income, and the only question to be considered then would be the question of graduation. The second reason is, as a matter of administration, a capital gains tax is an unsatisfactory tax. I understand it works in an unsatisfactory manner in the United States.

792. It does produce a substantial revenue.—Yes, it does, Sir, and to some extent it is complementary of course to some very generous allowances in the income tax field.

793. There again I think we did make a pronouncement that we were going to consider that aspect, and you may like to discuss with the Council of your Federation whether in the not too distant future you would like to put in a memorandum on it?—Thank you, Sir.

794. I think your Federation has considered the Liberal Party's and Lady Rhys Williams' schemes for the amalgamation of income tax with social welfare?—Yes, Sir.

795. And I gather you are against the proposal?—That is true, Sir.

796. I have been struck by the fact that these proposals were rejected by employers and employees, organisations on both sides of the fence, so to speak. What I should really like is a little more reasoned rejection if you can give me one; do you think it would increase the burden on industry?—May I make a preliminary statement, and that is that the British Employers' Confederation has, I understand, sent you a memorandum and most matters relating to employers' and employees' relationships are, on this side of industry, dealt with by that body rather than the Federation of British Industries, so that from the employers' point of view generally the views of that body I think should be considered in preference to ours, but we are prepared to make comments on it.

797. But I suppose you have to consider its effect on industry?—Yes, we do, and it is from that point of view that we would consider it. May I give you briefly the point of view which we adopt? First of all Lady Rhys Williams' scheme appears to us in principle to be unsound in making up the giving of personal allowances for two entirely different reasons. The giving of an allowance by the State under the Family Allowances Act or under other similar social security legislation is for the purpose of relieving particular persons, whether they are taxpayers or not, having regard to their personal and family circumstances. There is nothing given back by the individual for what the State gives to him by way of family allowance. On the other hand, the income tax allowances are not intended to be given as something by way of cash allowance to individuals, they are intended to be a means of differentiating a tax burden between one taxpayer and another, and for that reason it is very natural that with a progressive tax the value of the allowance as it is given as a lump sum should be greater as the income grows as the tax burden grows; therefore it is impossible in our view to consider one as parallel to the other, or as one replacing the other.

798. When they were giving evidence I did not entirely follow that that was their reason. One reason was that they thought that the family allowances gave the relief where it was most needed, whereas the other form gave the relief where it was less needed, they did not say that needed. They thought it was better to increase the relief where it was most needed?—May I put the point in a slightly different form because I think it is an important one? If, instead of giving a lump sum deduction from income in arriving at a taxable income, the system in this country were to charge a married man at one rate, a single man at another rate, and a married man with four children at another rate and the rate was consistent for the whole range of income, then quite clearly the value of that difference between the single man and the married man or the man with children and the man without children would rise as the income rises; that would be regarded as a valid way of differentiating a tax burden between one taxpayer and another, and it must rise as income rises. That is an entirely different course of action, and the intention is different, from giving a family allowance to an individual because he or she has a child and the State wishes to make some contribution at the lowest range to the support of that child. For that reason we feel that the two allowances are fundamentally different, they are given for different reasons, and it is a mistake to mix them up.

799. Do I follow from that that your Federation thinks that both reasons are valid and both allowances ought to be continued?—On allowances given for tax purposes the Federation has said in its memorandum that it is not satisfied with the present method of differentiation and graduation, and that is a subject which is proposed as an item for the second part of the memorandum. We would like to submit a memorandum on that.

800. I will not pursue that matter any further for the moment. The next matter I want to ask you about is this question as to whether tax can be passed on to the consumer. The Association of British Chambers of Commerce seem to suggest that because now demand is greater than supply the supplier can pass on the tax to the consumer. That seems to differ from the view that was taken by the Colwyn Committee when they were reporting on the subject.* Income tax being a tax on profits, is it really possible to pass on the burden of the tax except where the supplier has a virtual monopoly?—I have, if I may say so, personally considered this matter, and I have come to the conclusion—this is a personal view, if I may put it like this—that this particular consideration, though of extreme interest to economists is not very relevant when we consider to what extent the tax burden should be altered. I mention that because one can get awfully bogged down in considerations of a theoretical character which do not bear on specific proposals. I would say personally that in normal circumstances an income tax which is a tax on profit and varies only with profit cannot be passed on in price because if it could have been done, it would have been passed on in the price even if the tax had not been charged. There is one further consideration that, in so far as taxation has an effect on productivity, it reduces productivity, it is possible that the cost to the consumer rises. That is a different and technical consideration which is very important.

801. Is it your view that at the present time tax has a detrimental effect on productivity?—If you had eliminated the words "at the present time" I would have said yes. My own view, and I think it is the view of members of the Federation, is this, that a long period of high taxation has in the long run a detrimental effect. I think a high taxation imposed during a war and a high tax imposed in an emergency, are of a different character, but in this country we have had high taxes for a long period, and we feel, in comparison with other countries where the rates of tax have been lower, there has been a detrimental effect. We think it has had a detrimental effect not only on the productivity of workers of the manual class, but also on the attitude of mind of middle and higher executives. The attitude of mind of middle and higher executives in America appears to us, and some of us have had the opportunity of examining it carefully at close quarters in America, to be different from that in this country. We believe that to some extent, though we do not wish to over-stress it, that is due to the fact that a high portion of the reward for effort is retained by them.

* Report of the Committee on National Debt and Taxation. Cmd. 2990.

802. Was not that true, say, of the attitude of mind in America as compared with this country, at any rate to a considerable extent, even before the war?—Even before the war the rates of tax here were higher. That is one of the reasons why I say if you eliminate the words "at the present time", and if you refer to high rates of tax over a long period, I think it has an effect. In the same way I think if it were possible to reduce taxation very substantially in this country—we have no hopes of that—but if it were possible I would not look for a change in attitude for many years.

803. You mean it would take some time for the change to operate?—Yes.

804. Now I want to ask you a question on profits tax, if I may. Leaving out of account for the moment the question whether dividends on preference shares should be allowed as a deduction in the same way as interest on debentures, is does it not follow that a higher rate of profits tax on distributed profits than on undistributed profits may be justified as a spur to directors to move in the direction of reducing the amount of dividends they distribute and ploughing more back into business?—Yes, Sir. Clearly if there is a higher tax on distributed profits than on undistributed profits that will have an effect on the decision to distribute or not to distribute profits.

805. Is it not in times of inflation desirable to check excessive distributions of dividends?—I think the answer would be that first of all it is desirable but that this is not the best method of so doing.

806. What would you describe as the best method of so doing?—May I explain first what we feel to be the objection to the profits tax apart from the preference dividends? An income tax is deductible from a dividend that is paid. A profits tax is not deductible from a dividend that is paid. As a consequence, even if a company is paying the same dividend as before, an extra profits tax on the distributed proportion of the profits falls upon the company's reserves and in that case a company which has tried to maintain a reasonable price policy even though it may have had the opportunity of increasing prices, may be forced to put all its prices up, not in order to increase its dividend but in order to maintain the same dividend. There are cases which have been brought to my notice where the increase of profits tax on distribution has made it necessary for the company actually to reduce its dividend even though its dividend by all standards has been regarded as very moderate. For that reason we would regard a high profits tax or increased profits tax on distribution as inequitable and as not the best way of reducing dividends.

807. But assuming there has to be a profits tax, does that mean you are opposed to a differential rate between tax on distributed profits and undistributed profits?—I have some difficulty in that, Sir, because we regard the profits tax itself as thoroughly bad because it cannot be deducted from dividends. If you say—given there is something thoroughly bad, can it be less bad if it is different from what it is—

808. Is it a less objectionable form? That is the attitude of the schoolboy who is going to be punished, he would choose the less objectionable form of punishment.—I think I would say, in so far as there may be a question of reducing the profits tax, there is much to be said for reducing it on undistributed profits before you reduce it on distributed profits. I would like to add this on this point, every time there is an additional profits tax on distributed profits there appears to be the inference that the payment of dividends is a bad and an improper thing; that, from the point of view of British industry, we regard as unsound.

809. That was not the purpose of my question. Having commented on that method of inducement to plough profit back into the industry, you say there are better means; now would you tell me what you think are the better means?—I think the first method would be to adopt some means—and this is not necessarily, if I may say so, for this Commission, but taken generally—whereby the profits shown in the accounts were related more accurately to the true economic profits. In that case for many companies the distributions would not be raised, in fact they would be reduced. If the inflationary element in stocks and the depreciation allowances on fixed assets,

if too small, were taken into account in the computation of profits, it may well be that many companies would themselves seek to keep their dividends down, and that I would regard as one sound method, not the only method. Another method which is a much simpler one, if I may say so (I mention this because you asked me, it is not necessarily a taxation issue) is this: if, in fact, there was any real attempt to stop inflation then profits themselves would come down and the dividends would themselves be kept down. That we regard as the most satisfactory way of preventing the appearance of excessive profits and the payment of what appears to be excessive dividends.

810. The first method you suggested is certainly connected with taxation, but some time or other I shall certainly want to ask you questions about methods of dealing with replacement cost. I understand your Federation is proposing to put in a separate memorandum on that subject; if not, I will ask you about it now.—We would be prepared to deal with general principles now and perhaps any detailed points we could deal with at a second stage.

811. One method of dealing with replacement cost which has been suggested is that companies should be allowed to re-value their assets at the appropriate rate having regard to the increasing prices and generally compute depreciation allowance on those artificially increased prices. That would be, would it not, a benefit to the ordinary shareholders primarily, from the point of view of shareholders?—Yes Sir, it would be a benefit to the company; put it this way, you would be taking away something out of the profits which ought not to be there. In so far as you have got rid of an inequity or an injustice, then you can say you have done justice.

812. Yes, but of course what has been suggested to us from the other point of view is that companies, at any rate some companies, have gained from inflation in prices and the cost of fixed charges is thereby reduced. I do not know whether you can now or some time assist us in any way to measure, so to speak, the gains and the losses. It is obvious, of course, at least I think it is obvious, that this compensating benefit as regards fixed charges does not apply to all companies and probably the companies whose finances were the soundest gain least.—Would you care for me to deal with the whole of this question at this stage? I think it would be simpler if I attempted to deal with this question and make a statement now on this subject?

813. Certainly.—I believe it is difficult to deal with part of it without dealing with the whole.

814. I shall be much obliged if you would.—I think the way we look at it is this: that first of all, if we ignore who owns a business, we do maintain the point that before you can get at income, and income tax is intended to be a tax on income, capital must be maintained. When we say "capital must be maintained" we mean the capital which is necessary to maintain the same volume of production as before. That is not necessarily capital being maintained in the same money terms as before. If the value of money has fallen, then the amount of capital in money terms required will have risen. It is true that where there are charges on a business for all other purposes, not merely income tax but for all other purposes, price policy purposes, price control purposes, capital was maintained in this sense, then everybody who owned real assets and had a charge in terms of money, where the money was falling in value, would tend to gain. There is no doubt whatever about that, and that is a difficulty in dealing with specific blocks of assets, we recognise that. What we would say, however, is that the first principle that before you charge income you must maintain capital, is quite vital for the purpose of maintaining British industry. If it is not done, whether we are considering taxation or distribution of income as dividends, its real capital will in fact fall although money capital may remain intact, and if real capital is only one-third of what it was before the war then the productive capacity of that capital is one-third what it was. That is a state of affairs which we think is bad for the country, and we also consider it to be altogether unsound economically and for tax purposes. It offends the principle of charging income tax on income. To deal with that adequately means dealing with the difficult question of the fall in the value of money itself. Where there has been a catastrophe

fall in the value of money as in the case of Germany and other countries, it is quite clear that, whether for tax purposes or other purposes, the fall in the value may be and indeed has been taken into account for all these purposes: it is taken into account even for the purpose of re-constructing contracts entered into in the old money. It has been taken into account in determining what a charge should be on a property because if money falls away in value altogether then a man who has a house and a mortgage on that house has gained at the expense of the rest of the community.

What we suggest is that in this country we have not reached the stage where the fall in the value of money is so catastrophic that all contracts have to be re-stated and re-composed, and the fall in the value must be recognised for all possible purposes. That is an extremely complicated operation as we have seen in other countries, particularly in Germany, and is hardly justified at this stage especially as some of the prices may fall and some of the value of money may come back. But for tax purposes, for individual tax payers to take into account the maintenance of their whole capital, we feel that it is necessary to take into account the fall in the value of money. It can only be done, as we see it, in one of two ways, either by taking the individual assets and seeing what is necessary for the maintenance of that capital in those assets, or by taking the capital as a whole and seeing what is necessary to maintain the whole capital of that business. It would not be practicable as we see it to make any special deduction in respect of fixed charges if that meant that the capital of such concern was not being maintained. If you had a concern with nine-tenths of its capital in the form of fixed charges, fixed loans, then if you attempted to make a deduction from the fall in the value of money on the asset side by reference to nine-tenths of those assets because they are owned by persons with fixed charges you would not be maintaining assets in that particular business; but we feel that is one of those difficulties which has to be dealt with by forgetting it.

It is not possible at this stage of inflation to say that every person who owns war loans or consols is entitled to have compensation for the loss of his capital, that is going too far; therefore we have to concentrate on industry and concentrate on the maintenance of capital in industry.

We suggest that you take the assets stage by stage, you take the fixed assets and see that the charge for depreciation is such that the real capital invested in those assets is maintained, so that productive industry is maintained. We say the same in relation to stocks, that if in fact in the stock valuation there is an element of inflation that is not a true profit which should be regarded as a profit whether for tax purposes or for dividend purposes, it should be eliminated from the accounts of the company. It is not a true profit and should not be distributed in one form or another if the capital is being maintained.

We would agree that the same principles apply to those assets which consist of debtors and even cash. Even in that case it is true that the amount of capital required in the form of debtors and cash may go up in terms of money to maintain the same level of business. That is not always appreciated because the arguments are normally related to fixed assets and to such physical assets as stocks, but it is equally true for concerns where there is a large amount of capital invested in money and claims on money, and for them the position is slightly more extreme than in the other cases.

We feel it is not possible to deal with this other class of assets but it would be reasonable to deal with the fixed assets and the stocks, if necessary by some adjustment taking one year with another which prevents a particular concern getting an allowance which is altogether excessive. The way in which we suggest this problem should be dealt with at this stage is to say that we recognise the theoretical difficulty and the importance of maintaining capital; we recognise that it is not possible to have a theoretically perfect solution. Let us deal with those simple blocks of assets that can be dealt with and which are most important for the maintenance of productive industry, namely the fixed assets and the stocks.

So far as fixed assets are concerned, we maintain that there should be an allowance each year which represents the true usage or wastage of the assets as expressed in physical terms, because that is the true wastage from the point of view of the productive capacity of the country. So far as stocks are concerned, we suggest that if firms were allowed, as in the United States, to adopt a basis which itself eliminates the inflationary element—the basis is known as “Last in, first out”—or some similar method of valuing which takes this principle into account, then there would be no need for special legislation to deal with this matter. If the Inland Revenue or the Chancellor were prepared to allow such a method of valuation for stocks, then so far as stocks are concerned the matter would no longer be an important issue, it would be substantially dealt with.

So far as fixed assets are concerned, we suggest they should be dealt with on the lines which we propose. The exact method of dealing with fixed assets is a matter which we would suggest is for further consideration. There are several possible ways of doing it, either in relation to an index principle or in relation to a complete re-valuation. There are several ways in which it could be done and we would be prepared to put up specific proposals on these lines when details come to be considered. But the principle we maintain is that the capital in physical assets should be maintained not at the end of the life of an asset by some replacement allowance which is no good at all, but year by year in such a way that the company itself does not distribute what we regard from an economist's point of view as not true profits. Year by year the allowance ought to be such that an economist could look at that amount and say—“I regard that net profit as the true income of that company in that year.”

815. May I ask one question first of all. Is there any evidence that at the present time the volume of real capital required by industry as a whole is not available?—On that I am in some difficulty in that certain enquiries have been going forward and the result of those enquiries is to suggest that real capital in the form of fixed assets and stocks is being maintained or hardly maintained, the exact point is not easy to determine, only by doing two things, raising more money in the form of share capital and loans and by allowing liquid resources to run down. The general conclusion on the evidence that is being collected but which is not yet ready for issue is that the physical assets are hardly more than they were before the war, if anything in some cases in certain branches of industry they are less, and that has only been done by raising more capital. We would say that industry has been in the position of having to raise fresh capital and take fresh loans in order to maintain the same amount of physical productive capacity; that we would regard as thoroughly unsatisfactory. In so far as that has been due to taxation being on a basis which is in excess of the true income, we regard taxation on this basis as a very serious evil. May I say that we hope that evidence will be available shortly and I should like to have an opportunity of presenting it to the Commission when it is available.

816. The next question I want to ask you, and here again you may say you prefer to deal with it at a later stage, concerns your reference to the LIFO method as the means of dealing with the stock question. America has extremely complicated rules concerning giving options as to adopting that method as regards other portions of your stock and other methods as regards other portions of your stock which I should have thought would lead to administrative complications. I should like to know whether, if you recommend the adoption of the LIFO principle, you recommend that it should be made compulsory, and if so at what date, and that kind of thing?—We would want to make the recommendation that it should be optional because of the difference between different industries, but that does not mean it should be necessarily optional for one taxpayer to change having adopted the basis.

817. If you are going to put in concrete suggestions, I think it would be better if I postponed my questions until I saw what you had in mind. The other point I want to mention, which is not a question, is that your suggestions of dealing with fixed assets seems to throw overboard the proposals of the Tucker Committee and the use of

initial allowances to meet this question. I propose to leave questions on this subject to Mr. Carrington and Mr. Tucker. In paragraph 40 of your memorandum you suggest that where a taxpayer buys an annuity he should be exempt from tax on that portion of the annuity which represents capital. I understand that matter is being dealt with by Mr. Tucker's second committee,* so I shall not pursue that matter for the moment. You refer in paragraph 6 of your memorandum to the disincentive effect which may be attributable to the P.A.Y.E. system. I wonder whether you have any practical experience from your members proving the refusal of overtime owing to the P.A.Y.E. system?—Such evidence as we have is very conflicting. We feel that there may be some cases in which, genuinely, overtime has been refused because the taxpayer has reached the stage where he would prefer to have the leisure and the time rather than the extra income after tax, particularly when he takes into account that that extra income might only be spendable on what one might call marginal purposes which are themselves subject to very high rates of tax. The evidence is conflicting, and I understand that on this subject the British Employers' Confederation whom we are not representing today will be able to give you some much more detailed evidence.

51K. In paragraph 15 of your memorandum you say: "In the view of the Federation, short of a substantial reduction in the level of taxation as a whole, the removal of the worst effects of income tax upon the incentives to work can be achieved only by a fundamental change in the tax structure itself, which reduces the gap between the average rate of tax upon the wage or salary and the marginal rate of tax upon the top slice of that wage or salary."

I am not clear from your memorandum what the fundamental change you are recommending is, perhaps you would like to tell me?—We have suggested it could only be achieved by a fundamental change, we have not in this memorandum recommended a change. We have suggested later on that this is the subject of further study and we would like to make it the subject of a separate memorandum. If you wish me to explain the point, it is just this: that with any system in which graduation is effected by parts of the income being exempt from tax altogether and then subsequent parts of the income being charged at progressively higher rates of tax, it is, as a matter of arithmetic, true that the average rate of tax on the whole income will be lower than the rate of tax on the top slice of the income. Therefore the only fundamental change would be to abolish the whole system of allowances and to have a system of rates of tax appropriate to different classes of taxpayer over large ranges of income so that there is for those ranges no difference between the marginal rate and the average rate. That is the kind of change which we had in mind, but the matter wants a lot of careful examination and we are making that the subject of a separate memorandum.

519. When can we hope to receive these further memoranda?—I think you asked for them by December.

520. I do not feel very hopeful of that now.—We are working very hard and we will do our very best.

521. The next paragraph I want to refer to is paragraph 20, and there again you may say that is still the subject of further consideration. You point out the difficulty under existing conditions in the setting up of new businesses. Have you any suggestions to make as to tax alterations, other than the mere reduction of the rate of tax, which would facilitate the setting up of new businesses?—I think this is a difficult subject and slightly political, and that is why I am rather diffident to mention it. The rates of tax are so steeply graduated now, that in the case of a man either trying to set up business or to expand a business, it is impossible for him to build up reserves within his business. The top rate of surtax is so high that it is not possible for a small man to build up the capital in a business in the same way as was possible in the last century. That is a matter not only of the high average rate of tax, but of the very high rates of tax on the larger incomes, the incomes of medium-sized business proprietors. There is a second point, and this is related, that in so far as the present tax system charges tax on what from an economist's point of view would be more than the true income because of the inadequacy of the allowances for depreciation and the inclusion as

income of the inflationary element in a stock valuation, then the weight of tax may be such as to swallow up the whole of the true income of a medium size business. It may well be, in fact, that it may do much more than that. Those two factors together, the very high rates of tax above a certain level plus the fact that the measure of the income is wrong and is inflated, makes it practically impossible for the small man to expand his business, or for a man to get capital together to save enough money to start a business. That is what we had in mind. The remedies we propose will only go some way towards meeting this.

522. I gather from paragraph 27 of your memorandum that you object to the system under which business profits are taxed on the previous year's profits?—Yes.

523. Can you suggest a workable system of taxing on the current year's profits which would not involve a very heavy time lag before the revenue was collected?—The Federation did make a proposal in this connection and we have re-examined the original proposal in the light of the discussions. We are still prepared to recommend a change to the current basis. In so far as there are administrative difficulties, not so much in the changeover but in the actual operation of that basis, those administrative difficulties in this country are, as far as we can gather, the same as the administrative difficulties in other countries. Industries in the United States, Canada and other countries that have such a basis are substantially the same as in this country. If I may say so, I feel that if in principle it is right to tax current profits in the way proposed, then the administrative difficulties can be overcome.

524. If you are going to do it, is not, *prima facie*, the most satisfactory way the American system of self-assessment plus heavy charges in the case of under-assessment?—The charge of interest?

525. Yes.—We feel that that probably is the solution, that the proper system is estimation in the first instance by the taxpayer subject to the right of the Revenue to challenge the estimates.—

526. Of course.—Then if the estimate is consistently low, or is low in a particular year, that there should be a charge for the Revenue money which the taxpayer has had. In that respect, I think there is a change in what I am saying now and in what was said in the memorandum submitted to Mr. Tucker's committee.

527. I think that is so. I have only one other question that I want to ask you. In paragraph 36 you suggest that the logical method of dealing with the case of British industry carrying on business abroad is to subject to United Kingdom tax only profits which are remitted to the United Kingdom. Have you considered the effect on the revenue of adopting this proposal? Have you considered how much it would cost the revenue?—We have no figures for that it is very difficult for us to get them.

528. I am told the cost would be £100 million, that is a provisional estimate. Would you still favour the proposal putting on to the taxpayers generally £100 million, which I suppose would amount to about 8d. or 9d. in the pound additional charge on the income tax?—I would. I think my Federation would for these reasons, we do regard this as a very important matter. It is important not merely from the point of view of the incidence of taxation, it is important from the point of view of British trade abroad. It is also important from the point of view of Britain's relations with other countries of which I have had personally some experience. I know when I was in India advising the Government of India, that on this matter the feeling ran very high that Britain taxed the whole of the profits of the people within this country and taxed also all the income of these people within India, and then when India did not have very much control, required India to give a measure of tax relief in India in respect of British tax paid. They regarded themselves, that is to say the Indians, as the country with the primary right of taxing income in that country.

529. That works the other way as well.—That is true, but the number of Indians who have invested in Britain is extremely small, compared with the number of British people who have invested in India. That is in fact the reason why in all countries which are exporting capital, one base is preferred to another. In the case of Britain we have taken the best of both worlds and are getting tax on both bases. We did that because we started before anyone else and we cast the net wider than anyone else.

* Committee on the Taxation Treatment of Provisions for Retirement.

[1 November, 1951] MR. S. P. CHAMBERS, C.B., C.I.E., MR. C. D. HILLYAR AND MR. A. G. DAVIES

[Continued]

We feel the stage has been reached in 1951 when Britain ought not to regard itself as one country entitled to have a taxation not wider than anyone else's and then suggest that other countries should give relief in respect of profit arising within their borders for tax paid in Britain.

830. I gather your reason for recommending a change is not that, but because you think if a change is made it would improve our competitive position abroad?—Yes, there are several very good reasons. I cannot assess them, but I do mention that this matter, looked at from the point of view of taxation authorities in other countries, appears to be iniquitous, and that is an important factor. From the point of view of industry, there is no doubt that where countries have more liberal tax laws in respect of overseas income, their traders and their manufacturers setting up industries are in a favourable position in relation to British industry.

831. Mr. Crick: I was very glad to hear you say, in reply to a question from the Chairman, that you were providing some hard evidence of the impact of taxation upon industry. I do not want to press you to anticipate that any further than you have already but I do want to take up one or two questions on that matter in order to clarify my mind concerning the content of paragraph 28 of your memorandum to the Royal Commission. I think in that paragraph there are two aspects of this problem which are, if I may say so, a little confused. I am not clear whether you wish the Commission to understand that at this very moment the physical equipment of industry is being impaired by the rate of taxation, or whether you are arguing that the effect of taxation is to produce financial strain on industry and a distortion of the financial structure of companies. These I think you will agree are two aspects of the same matter, but nevertheless distinct. I gathered from your reply to a question from the Chairman, that you were under the impression there was not, up to the moment, any sign of deleterious effects upon the real or physical capital. Are we therefore to infer that the worst effects in your judgment so far are on the financial side?—I think I can answer this question by saying that we believe there have been effects in both spheres, but they are not necessarily the same for every branch of British industry. So far as our evidence goes there are some industries where the physical assets have not been maintained. In other cases there has been a good deal of capital expenditure, but its true physical quantity is far less than the monetary figure indicates. Taking British industry as a whole we feel so far from having expended the capital available in industry, it is being just maintained instead of being actually expended, but for some sections it will have dropped. We feel that is the conclusion which must be drawn. Looking at the figures it does mean that the amount of capital per worker in industry has probably declined although the total may be the same, because there may be more people at work. That is one aspect. The other aspect is, as you say rightly, the financial aspect and we feel that looking at the present state of figures and, if I may say so, looking at the figures sent in by the Bankers' Association, the financial stringency is arising. It has not yet been reached wholly, because of the large cash resources available to industry immediately after the war when there was a long backlog of unemplaced capital. That is arising, and my estimate is—I am trying not to forestall the evidence which is not yet ready but just to express a view if I may, Sir—that if the present trend continues then there will be financial stringency; it may come when inflation stops because the sources of capital available will themselves dry up, although industry is hoping to get the financial resources to maintain its physical assets and to get that out of what is in effect a growing inflationary position. When that stops and industry is unable to get further money to replace stocks at higher prices or replace its capital at inflated costs, then the absence of real savings will show at once that industry has not the liquid resources necessary to maintain its physical assets. Both of these factors are at work and are likely to emerge in the future. They have not emerged yet because of the special conditions after the war.

832. The evidence you are about to submit will distinguish between those two aspects of the matter and will, I hope, indicate where the impact is most severe?—Yes.

833. On that matter of the severity of the impact on different branches, I notice in paragraph 20 you suggest that high taxation is a contributing factor to the difficulty

of setting up new businesses and enlarging existing undertakings. Would the Commission be right to infer that in the judgment of your Federation that is a bad thing?—I think we were making this statement of fact without saying whether it was good or bad.

834. So the Commission will have to judge for itself whether it is a desirable consequence or not?—I think so, yes.

835. And on which side of the scale the balance lies. Similarly—in paragraph 12 your statement that the character of ownership and structure of British industry is changing—I wanted to ask whether in your judgment that was a good thing or a bad thing, but perhaps the answer will be the same?—This is, of course, not a matter of fact but a matter of judgment and of opinion. I should have said, and I may be expressing the views of other people in saying so but I must say it is my opinion, that the decline in this country of the very vigorous family concern which showed so much initiative in the 19th Century is to be deplored. I do not want to put it higher than that, but I think the present taxation structure does tend to penalise that kind of undertaking.

836. You made some statements in reply to the Chairman's questions about profits tax which I understood to mean that in your view the differential rates did have the effect of driving a larger proportion of profits into the business and withholding more from distribution; that is to say, if you had a flat rate, distribution would probably be higher?—I do think it is difficult to generalise but, as a matter of logic, that must be so. If there is a differentiation and that encourages people to put money to reserve then, as a matter of logic, if there is no differentiation there will be less encouragement to put money to reserve. I would stress the point that in the case of the continuing business which is not making more profits the weight of the tax on the distributed profits in the case of profits tax and not income tax falls on the reserves in any event. If you take a continuing business with roughly the same profits and roughly the same distributions, then although there may be an incentive to change from a tax point of view you may land up with the same total burden even though it may be a flat burden instead of a differentiated burden. It is quite true, we would admit, that a flat rate of profits tax would tend to encourage distribution more than a differentiated rate but, as I say, we find it extremely difficult and a slightly distasteful point because we regard the tax itself as so thoroughly bad because it cannot be deducted from dividends.

837. Suppose we go one stage further and accept your case for the complete abolition of profits tax so that the money now received by that tax has to be raised by additional income tax on personal incomes as distinct from business incomes; would you imagine that the removal of the load of profits tax from industry would lead to a larger distribution of dividends?—The removal of profits tax altogether where there is no differentiation between distributed and undistributed profits.

838. I was thinking of the present profits tax, remove that straight away?—I think if you removed the whole of the present profits tax which contains a differentiation, then logically there would be from the tax point of view an incentive to increase dividends. I would stress that we are coupling this with other measures which would, or ought to, cause people to reduce their distribution if they showed their profits more truly. I am thinking of the inflationary proposals which themselves should influence businesses or directors to distribute less profits. Taken by itself, I agree entirely that the abolition of 30 per cent. profits tax might encourage some people to distribute profits when they otherwise might not have done.

839. And the measures you would propose in substitution are largely outside the field of taxation?—I meant the ones which were within the field of taxation, partly within the field of taxation and partly outside. I am still referring to the elimination from profits as a whole of the inflationary element included in the profits both from the point of view of distributing profits and from the point of view of taxation.

840. Then may I just ask you one very general question on which you might like to speak. Having regard to what you have just said, we all know that in recent years taxation has come to be used as an instrument of economic

policy in addition to its purely fiscal functions. Do you personally regard that as a healthy and progressive development or not?—I personally regard it as a thoroughly unsound procedure and one which has led to some extent to the confusion in our taxation law. I think that taxation of income should be a tax on income, and the only sound principle is to determine what the income is and to charge that income according to its amount and regardless of the kind of income except where you wish to give special relief to particular cases such as charities. The use of the instrument of taxation, of income taxation I am referring to at the moment, not indirect taxation, as a means of implementing economic policy is unsound if it involves a departure from the principle of charging income equally if the amount of income is the same. I agree that in so far as you are charging income tax to prevent inflation or something of that kind the use of taxation as an instrument of economic policy for that generalised purpose is acceptable and sound, but the use of the instrument of taxation to differentiate between one kind of tax payer and another and one kind of income and another is bad. If I can give you an illustration of what I mean, it is not a very simple point if I may say to wish respect. The proposal which was made in Mr. Tucker's Committee's Report that the initial allowance should be different according to the importance of the industry, that we would regard as an unsound method of using the instrument of taxation for economic policy.

841. *Chairman:* May I interrupt one moment there? Would that apply to earned income? Strictly speaking your answer would cover earned income?—No, I was trying to say that taking income so far as the difference between earned and unearned income is concerned, I regard that not as a method of picking out different types of income according to the source of the income, but rather a special method of dealing with personal incomes as distinct from incomes which are not personal incomes. There are, I think, as the evidence before the Royal Commission in 1920 indicated, good reasons for saying that a man who is earning his income and who has no allowances for the exhaustion of his personal capital and a few other things should be charged on a lower rate than a man whose income is entirely derived from sources outside his own efforts. I would not regard that as a breach of the general principle.

842. *Mr. Crick:* You have made very clear your objections to discriminatory allowances as an economic instrument. Would you object equally to the raising or lowering, or the institution or removal, of initial allowances from time to time?—I said I disliked the differentiation in the initial allowances, but here again personally I regard the initial allowances themselves as unsound and therefore, having been removed, with what inequity we need not discuss, I would deplore their re-introduction in any event because I think it does involve taking a measure of income for a year which is not in accordance either with an economist's idea of income or even an accountant's idea of income for that year. It does involve taking a completely artificial measure and I think it is unsound.

843. *Mr. Crick:* You do not deplore the removal of it?—I have said I think that, having been introduced, the method of removal may have caused inequity, but I think their introduction, instead of the introduction of something sounder, and their sharp removal, the whole of it, was an unfortunate episode. I would prefer not to see them re-introduced, that is how I see it.

844. *Mrs. Austin:* I have one or two questions about linkage between social insurance and income tax. I think you suggested at one point that, although your Federation does not approve of linkage, it might be possible to have some more administrative co-ordination. I wonder whether you could be more explicit upon that point?—We did say we would put in another paper on this subject. We do feel that the present rather complicated system of getting all the particulars twice by two Departments is unsatisfactory, and that some system might be adopted of merging some of the work. We have not got very far with that yet.

845. I see, I did not know that was coming. There is just one other point. You want I believe to retain and perhaps extend the insurance principles. I wondered whether you could say a little more about how you intended to extend the insurance principle? Is it your idea that one might increase the insurance contribution and,

by raising more by means of insurance, perhaps need to raise less by means of taxation, or something of that sort?—Our point was that in so far as people get benefits for nothing, benefits of a certain character for nothing, that is undesirable. So far as they are insurable and there is an insurable interest in the matter, then it is reasonable and logical for the three main parties, the employers, the employees and the State, to contribute; we have said, only in a general way without specifying it, that that principle ought not to be weakened. We would prefer to see it strengthened. I think we had in mind as much as anything else those benefits which have been paid entirely free of charge.

846. Would not that involve a very considerable increase in the contribution per head which would mean a very big additional burden on the lower income groups?—In so far as you increase the insurance element as distinct from the free element that does mean an increased contribution. Taking the community as a whole, we would say that there was much to be said for that, even if it meant in the lower levels where there may be hardships giving special relief in a different form, giving in effect relief because of the small income even if the insurance principle is extended throughout the whole range of income in the whole community.

847. So you advocate increasing the insurance element. What effects do you consider that would have on taxation? Is it your idea that that would enable the rate of taxation to be a flat rate over a larger range, or something of that sort?—On this particular point all we were saying I think was that the giving of benefits free may encourage waste, that there is something to be said for increasing the insurance element without causing hardship in the lower ranges of income. We have not attempted to quantify this and we have left it as a general statement of policy. What we would say particularly is that we would not like, as in Lady Rhys Williams' scheme, the complete abolition of the principle; if anything we would prefer to see it extended but we have not attempted to quantify it.

848. *Mr. Hicks:* Could I go back to the replacement cost matter? It seemed to me that the argument which Mr. Chambers was producing could be interpreted by someone who was unsympathetic to his proposals as representing a strong case for saying that companies should be prevented from paying out in dividends more than they were earning according to his definition of profit; that that had a bearing not so much on principles of taxation as on other aspects of the legal structure and calls perhaps for a reform in company law, if I may say so, rather than in taxation law?—I would say, in answer to Mr. Hicks, quite definitely I think that if a company does pay out in dividends, and pays taxation appropriate to the dividends, for one is taken from the other, something in excess of the true profit after provision for depreciation and the inflationary element in stock, then it is failing to maintain its real capital and it should not do so. When you say to me—"Given that as a general principle how would I see that implemented by alterations of the Companies Act?"—that is an extremely difficult matter. It is so often a matter of determining what is a profit on good commercial lines and then saying that nothing other than profit is available as distributions. It is not always easy on such matters to say—"This part of the Companies Act can be altered and the job is done." It is much more a matter, although you people understand these things better than I do, of saying if you get a good commercial practice then you apply the Companies Act in relation to that good commercial practice.

849. *Chairman:* I see no reason to dissent from what you say.

850. *Mr. Hicks:* If I might continue the point a bit further. The thing is that it is undesirable in the interests of the country, and in the interests of the company as an element in the economic structure of the country, that its resources should be allowed to run down. On the other hand, when it comes to the question of taxation, is not the company there rather more to be considered as representing the shareholders, and is it not rather a question of equity between shareholders and other possible interests that have to be considered? Is it necessary that the same principle should hold on the taxation side as on the other side?—I would say it is necessary to do so in so far as a company is regarded as representing its shareholders. If you take the simple case where it distributes the whole of its profit, the simplest possible case, then the shareholders have to pay sur-tax on what they get and the inequity

of charging income tax is carried right through to surtax as well, and you have still the same inequity. If you say there are other taxpayers who are subject to the same trouble, my answer would be that I admit that there are other taxpayers who would be charged tax on something more than their true net income, and whether something could be done for them is another matter. The great body of taxpayers, the wage earners and the salary earners, are not of course in any way subject to this point because the question of determining true income does not arise. The income is in fact gross and net and it is the same. You have not there to bear in mind the maintenance of capital.

551. The real point, is it not, is as between the ordinary shareholder and the debenture and preference shareholder?—Yes, it is in fact the person who owns not the equity, the person who owns any form of an income right, it is a money right and not an equity right: in every case where the money value of his capital has shrunk there is inequity in not taking into account the fact that the capital has fallen. The obvious case would be if war savings certificates were subject to tax, they do not happen to be at the moment, the fact that you get paid out in 1951 £20 more than you paid in 1934 means for the moment you have £20 more income; but you know in terms of actual income, what you can buy, you are taking out less than you put in, and in that case the inequity runs there as well. I would say the solution is not to say, where there are a certain number of taxpayers to whom this inequity also applies, do nothing for British industry, but do it in the cases where it is important and it must be dealt with, and do it if you can in other cases.

552. Could I put the question in this way? If the Commission were able to find a way, I do not say there is one in sight, but if it were able to find a way of protecting the interests of firms as unities and of companies, which prevented them from getting into these difficulties while at the same time doing as little as possible to improve the position of the ordinary shareholder as against the debenture holder, would you consider that was very vicious?—It is difficult to answer this on the basis of generalisation but, in so far as an ordinary shareholder was getting a fortuitous gain because there was a large part of the capital in the form of loan stock, and you devised some means of seeing that industrial capital was maintained intact without giving undue advantage to the shareholder, I would agree that that was sound.

553. Mr. Kaldor: I have just a few questions regarding this rising replacement cost. Would you say one could quote any particular figure as being roughly the order of magnitude of the rise in the cost of replacing capital goods as compared with before the war?—It differs of course for different classes of plant because some raw materials have gone up far more than others. To give a simple example, non-ferrous metals of certain classes have gone up enormously and therefore the replacement cost of that kind of plant is much higher than before the war. In fact there are published figures, the Board of Trade Indices of construction costs, which indicate I think that the cost now is of the order of 300 to 100 over pre-war, something of that order.

554. Three times the pre-war level?—Three times the pre-war level.

555. We had some evidence submitted to us which suggested it was two and a half times as compared with pre-war?—It may have gone up since then.

556. Anyhow, it is between two and a half and three times, that would be right?—Yes.

557. You would say of your knowledge the physical capital of industry at the moment is not much higher than before the war?—Yes, I am embarrassed in that I am not in a position to present the evidence, but I would say in my opinion that is approximately correct.

558. Would you then say, if the physical capital is no higher than before the war, the real annual depreciation of that capital is about the same as before the war? I should think that follows from your earlier statement. If there are no more real assets than before the war then real depreciation is the same?—Assuming they are the same types of assets, yes.

559. We have some figures to show that the depreciation allowances before the war amounted to £450 million. That of course includes all companies, not all industry, but I cannot separate it out at the moment. Two and a half

times that amount would be about £1,125 million. The actual allowances in 1950 were £1,125 million of which £850 million were in the form of depreciation allowances and the remainder in the form of initial allowances.* In other words, industry did get in the way of tax free allowances two and a half times the pre-war amount in 1950. You would agree to that?—The figures are completely bedevilled, if I may use that word, by the initial allowances, and in the enquiries we have been making we have been trying to do the laborious work of separating these two properly, because you cannot just take initial allowances and annual allowances and say so much was one and so much the other, because every time you grant an initial allowance you reduce the annual allowance. There is a further point which raises a difficulty and that is that so much of the capital was put in more recently after the war. During the war there was a long lag for a lot of peace time construction and suddenly a lot of this was put in. Instead of war-time there was a changeover from war to peace and there was heavy expenditure of capital in the later years you referred to, a disproportionately heavy amount in comparison with earlier years, and therefore it is probable that these years are over-weighted by initial allowances. It does not mean if the sum total of those two allowances is equal to two and a half times the amount of assets before the war that industry is necessarily getting what it should get, because it has to be remembered also that those initial allowances will have already been given and will result in smaller allowances in the next few years.

560. That would only be the case in so far as those initial allowances are not continued to be given. On the assumption that initial allowances are continued to be given year after year, surely the allowance would continue to be given as capital is being replaced?—With respect, I hardly think so because the capital expenditure has not been even. If you maintain capital expenditure of this particular kind at an even rate then, sooner or later as a matter of simple arithmetic, for industry as a whole, whether you gave initial allowances or not, the total allowances for industry as a whole would be exactly the same. The total allowances would equal what you give by way of ordinary allowances.

561. So to the extent that you continue to give initial allowances it would be right to suggest, would it not, that the depreciation allowances in general accrue to the industry at an earlier date than they would be accruing under the system of no initial allowances?—Certainly.

562. To the extent that prices are rising, you would agree that the fact that industry is getting those depreciation allowances at an earlier stage represents an offset against rising prices?—Yes, some offset.

563. But you now say you would regard this large increase in depreciation allowances as compared with pre-war, this two and a half times increase, as in part a reflection of the initial allowances. Actually we know it is only partly a reflection because initial allowances have gone up to £250 millions but, having regard to the fact that a great deal of plant has been replaced after the war, to the extent that is true, would not it also be true to say that a case for re-valuing assets for the purpose of depreciation is also to that extent weak?—In so far as there has been capital expenditure at the higher prices, then the question of replacement would not arise, or it only arises in so far as there has been an increase in construction costs between those post-war dates and today.

564. May I just go on with this. Some suggestions were made of re-valuing for depreciation purposes assets that were installed before 1940 or 1941. We know that the pre-war figure of depreciation allowances was £450 millions. I think you would agree that the greater part of those allowances then given were in respect of assets which in the meantime in the intervening ten years must have been completely written off?—The greater part?

565. Chairman: What was that?

566. Mr. Kaldor: Which have been completely written off in the intervening ten years?—I would not like to agree or disagree without examination of the figures because those figures to which you refer cover, I understand, buildings as well, buildings, plant and machinery, some of which will be only allowable at a very low rate of

* National Income and Expenditure of the United Kingdom 1946 to 1950. Table 6, Cmd. 8303.

depreciation and, following the Inland Revenue method, the allowances are given at the written down value. Therefore without an analysis of the figures I cannot say how much would represent plant subsequently completely written off. In fact, as you know, following the Inland Revenue method, no plant is ever completely written off until it is scrapped.

867. I suppose it is true to say for the bulk of plant as distinct from buildings that it is written off over ten years or so?—For Inland Revenue purposes we would very much like it. I fear that the average rates are far lower than that. The average rate on the written down value basis, if you have 10 per cent. on a written down value basis, does not write off over ten years. I am not good at arithmetic but it would be nearer twice that before you get down to one-tenth of the value.

868. Would you say it is an exaggeration to say that only about half the sum given before the war would still be relevant in the sense that it would represent allowances in respect of assets which have not yet been written off? I am only trying to carry you into a little calculation. Could we accept that for the moment as a basis of argument?—If I may say so, I cannot myself accept it because I have not examined the figures.

The proceedings were adjourned accordingly.

On Resumption.

Chairman: Mr. Kaldor, will you resume your interrogation of the witnesses?

872. *Mr. Kaldor:* I have a few more questions to ask, Mr. Chairman. Mr. Chambers, your main contention was, I take it, that with the present system of taxation and with the present system of giving allowances for amortisation and depreciation, industry is not in a position financially to set aside sufficient amounts to maintain real capital intact. That is right, is it?—I would say that the taxation is charged upon capital as well as income. It does not mean that in every case, as the tax is not 100 per cent, it is necessarily paid out of capital. It is in fact charged on something which is income plus a portion of capital.

873. From the point of view of the economic effects of taxation you would agree that whatever way tax is charged it is detrimental in so far as it makes it impossible for industry to replace . . . —Yes, certainly.

874. If you look at the National Income White Paper, you will see from Table 6 that in 1938 £457 million were allowed to industry as depreciation, and from Table 34 that in addition a sum of £172 million was set aside not in the form of undistributed profits. At that time income tax was 5s. 6d. in the £. If it had been 9s. in the £ and if, in addition, profits tax had been in force, the amount set aside would have been considerably smaller than £172 million net?—Yes.

875. If you look at the figures in Tables 33 and 34 you find that despite the very heavy increase in taxation the amount which industry set aside in the form of amortisation and undistributed profits amounted in 1950 to £1,750 million, or £1,693 million to be exact, which is practically three times the amount set aside in 1938 despite the fact that taxation is now so much higher, and these figures are net of tax. You will agree?—Yes.

876. Would it follow from this that if industry was able to set aside enough to maintain capital intact in 1938, it is now equally in a position to set aside enough to maintain capital intact, prices on your admission have not risen by more than three times and the amount set aside is three times as large?—If I may answer in this way. The operation of setting aside profits to reserve is not, of course, a cash transaction, as you appreciate. It is a book transaction and it is related to the book profits. We argue that the book profit is inflated. You put part of your inflated profit to reserve, therefore you have not in fact saved anything out of your cash. If you over-state your profit by £100 million and then you set £100 million out of your over-stated profits to reserve, you have not got another £100 million at all. We argue, and indeed the figures which I hope will be available sooner or later will show, that the amounts set aside so far from being the same are much smaller ones. You

869. But if one were to accept it, it would be true, would it not, that if one were to grant this claim for replacement costs altogether industry would be relieved of taxation to the tune of about £300 million a year or something of that order?—Could I have the calculations again?

870. Assuming that of the pre-war £450 million about one half represented assets which in the meantime had been completely written off and half assets in respect of which allowances are still being given, these allowances are now re-valued in the ratio of 2½, it would be about £300 million?—It would be tax on £300 million.

871. So in other words it would mean an increase in the depreciation allowances granted to industry of the order of about 25 per cent. on that basis as against £1,200 million? On the other side, you would agree, would you not, that as the result of inflation industry benefited in this respect on fixed charges; I think that was agreed?

Chairman: I think we shall have to adjourn now because of the luncheon arrangements. If we adjourn now, Mr. Chambers, would it be possible for you to be back at 2 o'clock or do you want longer?—No, 2 o'clock.

have taken out of the profits the inflationary element included, as a consequence the cash position of industry is shrinking; the cash available to business is shrinking very much as is indicated by the memorandum prepared by the Institute of Bankers. In effect your reserve position, your book position, is only of value in so far as it indicates what is happening or going to happen in the long run to your cash. If, without having built up your physical assets beyond a certain point, your cash has been shrinking, that I think is clear evidence that the book figure of profit, much of which is put in as a book figure of undistributed profits, is an inflationary figure; and if in fact, I have not looked at the figures you were quoting, I have looked at others but not at the moment, the figure for undistributed profits is only three times what it was before, that is strong evidence to my mind that the taxation and distribution together have been excessive.

877. I did not say the undistributed profits were three times, but the undistributed profits plus what is allowed for depreciation.—Yes, I meant the same. It is the same operation.

878. Your case is simply that industry's cash position is shrinking. That is your major evidence?—The cash position is shrinking at a time when the physical assets have not risen. Cash is shrinking and the physical assets are remaining unchanged, and in order to maintain that position industry has had to get fresh capital from the capital market.

879. I find it a little difficult to understand why if the industrial accounts do in effect show amounts available for reserve—whether it is a replacement reserve or whether it is another reserve namely a net which is booked as a net addition to the assets of the company, it is so different—if this sum has risen three times in one sense it is not true to say that there is three times as much available as there was before the war for the purpose of capital investment. The fact that the cash position of companies is shrinking may be due to a lot of other things. It may be due to the fact that their stock and recurrent assets are going . . . ?—No, I am sorry. The position is quite clear. If your total assets, physical assets are unchanged and your cash assets have fallen, and if to maintain that position you have had to borrow money and to raise fresh capital then you have not got increased true reserves. May I give an illustration of the way in which it can happen in relation to stocks? If you had the simple position that you had 100 tons of a particular kind of stock to start with and it is £100 a ton, that gives you £10,000 opening stock. If during the year you have bought another 100 tons and, for simplicity, you bought it and sold it at £300 a ton, at the end of the period you will be left with 100 tons shown in your books as worth £30,000. Your profit in your books will be

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increased and inflated by a sum of £20,000. If you place that sum of £20,000 to reserve it does not mean that to that extent you had increased resources. That £20,000 placed to reserve is no more than the representation of the inflationary element included in the valuation of your stock. That is the point I am making.

820. You realise, of course, that the National Income White Paper does give you figures on that too? They estimate in Table 33 the amount of profits which represents the appreciation of stock at £205 million in 1950.—Yes.

821. Even if you make the appropriate correction and deduct these figures I suggest you still find that the increase in the amounts set aside by industry are probably quite as large as the rise in price, and you really ought to take into account also the increase in rates of taxation. In other words I suggest to you, Mr. Chambers, that if prices had not risen since 1938 but the increase in the rates of taxation had occurred, then industry today would be in a worse position than it actually is. In other words the existence of inflation has not aggravated but mitigated the effects of higher taxation on industry.—If that is the question my answer would be that it is difficult to ascertain the facts in relation to what has happened, and that I have said we are going to try to do. To attempt to ascertain the facts of what would have happened if we had maintained these enormous rates of tax but there had been no inflation is very nearly impossible. The huge increase in taxation is very largely related to inflation itself. I would suggest that there are circumstances in which inflation does mitigate the position for industry, and I have admitted that that must be so in relation to fixed charges, but may I suggest, Mr. Chairman, that on this very matter the documents which I hope will be coming forward will make the very adjustments that Mr. Kaldor is asking for only in relation to certain sample figures admittedly, with as great a degree of accuracy as is possible in relation to that sample, and it does show the results which I have broadly indicated.

822. You agreed this morning, I take it, that while the rise in prices causes hardship to industry, or rather to the interests of the ordinary shareholder to be precise, on the one side owing to the fact that depreciation is calculated on an historical basis, on the other side the ordinary shareholder benefits through being relieved of the burden of fixed charges. Supposing, as has been done in effect in past inflations, that there were a revaluation scheme by which on the one side depreciation were put on a replacement cost basis and on the other side debenture interest and preference interest were equally revalued with the rise in prices, would you, or would the Federation of British Industries, still advocate revaluation in that case? In other words revaluation would extend not only to the credit side of the balance in business but also to the debit side. Would you still say from industry's point of view revaluation is preferable to non-revaluation?—As far as the Federation as a whole is concerned this specific proposition has not been put to it, I would say at once that my personal view, and I think it would express the view of my colleagues, is that we would accept, whether for taxation purposes or other purposes, such relief because it is quite clear that the gross assets of business are much larger than the charges that have to be incurred by business in respect of fixed loans and so on, so that there would be a net gain for business, and if such a system could be worked out it would be certainly better than doing nothing at all. It is a logical thing to do.

823. I am not sure that I agree with your argument even if it is true to say that gross assets are much larger than the amount of loans. On the other side you have to take into account that depreciation allowances do increase because assets wear out and are actually replaced. You have to take into account the fact that depreciation allowances have gone up about two-and-a-half times since the war, whereas the payments made on debenture interest and preference dividends have remained unchanged?—It may well be, of course, that if there is some inequity which is in favour of the ordinary shareholder which is taken away by such a proposal, that would be still worth while, seeing that on balance most companies are not insolvent; their assets exceed their liabilities. That must be so.

824. *Sir Harry Gill:* Mr. Chambers, earlier on in your remarks you told us that you did not favour the scheme as put forward by Lady Rhys Williams. There was a somewhat similar scheme put forward by the Liberal

Party. Does your objection apply equally to both schemes?—Yes. The difference between the two schemes is not a difference of principle so far as what I have already said this morning.

825. Thank you. Then later on referring to the social service costs you put it that the Federation favoured the idea of the contributory method of raising the necessary finance.—Yes.

826. Under the contributory method is so far as it has been adopted that has been on a flat rate basis. For instance, where the contributory rate now applies the wage-earner of £5 a week is paying the same contribution as the wage-earner of £10 a week?—Yes, Sir.

827. In both the Liberal scheme and Lady Rhys Williams' scheme that theory was strongly attacked on the question of ability to pay. Now under your contributory scheme I cannot see how there could be any differential contributions. What is your answer to that criticism?—I think my answer to the proposal in the Lady Rhys Williams scheme and in the Liberal scheme is this: that we would regard the contributory scheme as in effect each person buying a certain amount of insurance and, just as when he goes to a shop to buy a pair of shoes, whatever his income he has to pay the same price for what he gets, so, if he buys insurance he pays the same price regardless of his income. That does not mean, and I emphasised this this morning, that I would not agree substantial relief to the lowest levels of income where there is hardship; above that they should pay for what they are buying by way of insurance just as if they were buying in a shop or from an insurance company.

828. You do not accept the criticism in both the schemes on the ability to pay?—No.

829. When you were dealing with the question of depreciation allowances you divided the problem rather into two categories. One was the question of replacement costs and as regards the other you used as an illustration holders of war loan, consols, etc.—Yes.

830. So far as the physical assets side and replacement costs were concerned you therefore thought the position ought to be met, but you did not think anything could be done regarding the position of war loan, consols, etc.?—May I make a correction? I think what I said was whether anything could be done or not in relation to the owners of fixed loans, and I included war loan holders as well, it was essential I thought for the problem to be tackled for industry because it is vital to maintain productive capital. I did not say, I think, that in my judgment nothing whatever could be done. It is just that the matter had not yet been considered so far as we are concerned. It is not an industrial problem but a general taxation problem. If in fact the problem could be tackled and tackled equitably, I am quite sure in British industry we would accept such a proposal.

831. But you are putting forward no suggestion regarding them today?—No, that is true.

832. And therefore it would be fair to say they were rather in a second category?—Yes, that is perfectly true.

833. Do you feel that that is correct? Surely the owners of physical assets under inflation do have the opportunity for recompensing themselves to some extent because the value of their physical assets remains?—That is true, and in so far as they have fixed charges, and of course many of them have no fixed charges, they do have some fortuitous gain, but what I tried to emphasise is that the present system of taxation is eating into industrial capital and that whatever we do we must at least maintain our productive capacity; that here is taxation of something more than income. So far as industrial capital is concerned it is vital that we should maintain that otherwise the basis of everybody's income falls. You must tackle that as the primary problem admitting that if you tackle it completely and exhaustively you have left other pockets of inequity still to be dealt with, but the existence of these pockets should not be a reason for not tackling the main problem of maintaining British capital.

834. I am looking at it from the standpoint of equity as between two men, one of whom has put his savings into company shareholdings, the other one has put his savings into consols and that form of investment. I feel that the second man is in a far worse position than the first because the second man has no opportunity whatever of regaining what he has lost or increasing his income. I would say the man who has put his savings into capital

investments really in the physical sense has lost nothing and has the great probability of his income increasing and himself really being in a very little worse position; but you say in spite of that anything that has to be done must be done first for the man with his investment in a company?—Not so much for the man with his investment in the company but for the company, and the maintenance of British industrial assets. That is the first thing.

895. Yes, but it will eventually come down to the individual shareholder and what he receives, will it not?—It may do, but in answer to a question put by Mr. Hicks . . . he asked me whether, if something could be done to maintain British capital without giving an unfair advantage to the shareholder as against the loan stockholder and war loan holder, I would be in favour of it, and I said yes.

896. Yes, I will leave it there. You know under our terms of reference any benefit we give to meet your difficulty has probably got to come from somewhere else. There is only one more question, Mr. Chairman. I would like to ask Mr. Chambers, in spite of increased taxation and all the other difficulties business has had to meet from the standpoint of profits and reserves, is industry in a stronger or a weaker position today than it was in 1939?—That is the question to which I have made reference several times, that I am hoping evidence on that will become available, but the short answer is as far as I know at present the amount of fixed capital is roughly unchanged, liquid resources have shrunk and that evidence is supported by the evidence of the Bankers. In relation to the total production of the country industry is in a weaker position than it was before the war, and if it goes on at the present stage we may find ourselves in a perilously weak position.

897. And you are giving us evidence to prove that contention?—We hope so, yes.

898. Chairman: Yes, Mr. Kaldor, have you another question?

899. Mr. Kaldor: Mr. Chambers referred twice to the evidence presented by the British Bankers' Association regarding the shrinkage of liquid resources in the hands of industry. That evidence, as you probably know, has been made public. It relates to a comparison of different post-war years; it shows the shrinkage of liquid resources in 1950 as compared with 1945 and 1946. You realise that?—Yes.

900. Is it not true that at the end of the war the financial state of companies was abnormally liquid because of the fact that during the war real assets had shrunk, stocks had been diminished and the reserves set aside could not be actually used. Therefore you would expect, would you not, that liquid resources of companies would shrink with the replacement of assets after the war and with the rebuilding of stocks after the war?—Yes. I merely was saying that the evidence which we hope to produce would show the position as between pre-war years and today, but it happens that although the approach was entirely different in respect of the post-war years the position produced by the Bankers' Report is substantially the same as the evidence produced in an entirely different manner.

901. That evidence has not yet been seen?—No.

902. Mr. Kerwick: My questions are very general ones. I understand it to be the view of the Federation that the resources of companies are running down because of the lack of depreciation allowances. Would you consider this a matter of great urgency or a trend only?—I would consider it a matter of great urgency at the present time. I believe that the evil effects of the over-statement of profits have not emerged because of continuing inflation which has kept the pot boiling, may I put it that way, but that when the inflation stops the full effects of the evil will become apparent. I regard this not as a long-term problem alone but as an immediate problem.

903. In other words in your opinion if something is not done about it the results will be, to put it strongly, disastrous?—I would say so.

904. Another general question which is pressing you on an opinion you gave this morning in connection with the overseas income. I think you said or advocated that only profits remitted should be taxed which was translated into figures; approximately this would mean a loss of revenue

of £100 million which is 8d., or possibly 9d., income tax. I understood you to say that in spite of those figures you would advocate only taxing remittable profits?—Yes.

905. The Federation might feel on the other hand that the extra burden of that 8d. which might be spread over industry would be unfair. Would you consider that?—First of all the figure of £100 million is a figure which was quoted in public debates on the subject. I have not checked that figure and, indeed, it is an extremely difficult figure to check because we are discussing not merely profits which are made overseas but that proportion of branch profits which are made overseas and it is terribly difficult to get anything like a genuine figure of how much of a profit arises abroad where there is manufacture in this country and sale overseas or vice versa, or where there are factories overseas getting raw materials from here and so on. It is an exceedingly difficult figure to check and, of course, when figures are very difficult one person's guess, and it is little more than a guess, is treated as good as another person's. I would say if in fact the figure is £100 million the point of principle is so important that I would prefer to see the burden distributed generally and taken away from this taxation of reserves of profits maintained overseas.

906. And the Federation would share your opinion?—As far as I am aware they would. We have consistently advocated taking away this burden from the profits unremitted and it has been the practice of the Federation whenever making recommendations for taxes to consider the thing as a matter of equity and not merely claim tax reductions. If the proposal were to spread the balance of that tax then we would accept it.

907. My last question is a small one and a general one again. I understood you to say that you were against initial allowances root and branch?—Yes.

908. Does that mean that you would go as far as saying that they would not be better than nothing?—That is a very difficult question; but I would say it is impossible to say they would be better than nothing in terms of what is given to British industry. If you have an allowance in year 1 instead of years 2 to 10 then you have got something like a tax free or interest free loan, and by getting it in the year 1 you have money which you would not otherwise have had available because the Revenue is postponing the collection of tax. But in practice if you look at the initial allowances as they were given, the rate of tax was increased after the initial allowances were taken away and so it did not even amount to an interest free loan, but if you ignore the question of differences in rates of tax between one year and another, if you assume a completely even rate of tax over all the relevant years, then an initial allowance means a definite benefit I would say, and, I am here speaking more about a principle than anything else, notwithstanding that I personally would regard it as bad because it is getting away from the principle of taxing your profit as determined on normal commercial principles and using that as your income tax measure of profit to distort the profit between one year and the next. It would give a tax advantage to industry but I think it is unsound.

909. Mr. Greenwood: I am sure you feel that industry will have to raise increasingly large amounts of fresh capital in the future?—Yes.

910. Do you think that is going to be easy?—I think it is going to be extremely difficult unless there is a continuing inflation in which case it might well be that industry, or some parts, might get some part of the resources which were not necessarily best applied in that way. On the whole I would say that it is going to be difficult for industry to get capital in the few years to come.

911. And you would agree, of course, that if profits showed a downward tendency as they might well do if they were the true profits, that might be very much more difficult?—It certainly might be very much more difficult, yes.

912. And of course the present action of profits tax does drive companies into the ways of debenture and notes; do you think that is a good thing or a bad thing as opposed to the issue of ordinary shares?—If I may say so this is not strictly a tax question, and it is a matter on which one would naturally feel some personal embarrassment having regard to what has been taking place in particular cases, but I would say in general and as a

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[Continued]

matter of principle it is wrong that the tax structure should force companies to do things one way rather than another way if the tax structure were correct. If the tax structure distorts the method of raising capital then that is a bad. I would just add this: that in so far as it is difficult to raise equity capital and easier to raise money in a different form in debentures, that tends to act to the disadvantage of certain types of concerns and to the advantage of others. Very large companies are in a much better position to raise money by way of debentures or notes than small concerns, and very small concerns have this particular method almost completely blocked. Therefore my general answer is on the whole, I think, that tax effect on the method of raising capital is a bad one.

913. There is one other point, I think it was in paragraph 32, you refer to the fact that industry was coming more and more under control of salaried officials and you thought that perhaps was not a good thing. Is the reason that there is really no incentive? Taxation is so high that there is not much incentive for those managers to increase profits?—I think I was careful not to say definitely that I thought that this tendency was a bad one. What I did say was that there were certain classes of industry or branches of industry which were adversely affected, and I thought that was most unfortunate, but whether the general trend towards the salary controlled concern as against the equity controlled concern is a good one or a bad one is a matter of social policy, of social theory upon which I do not think my judgment is any better than anyone else's. It is not expert in any sense.

914. Sir Geoffrey Heyworth: You said, I think in reply to a question from the Chairman, that certain taxes were reflected or could be reflected in high selling prices, that in general if you eliminated inflation you thought it . . . —I put a special emphasis on the termination of inflation. Where it is possible to increase prices because of inflation there may well be a tendency to put up prices to take account of extra tax burden.

915. Would you qualify what you said in relation to a profits tax in particular and what you generally call corporation taxes which you see in other parts of the world; that, in fact, when considering any project, knowing that these taxes are in existence, does the man not consider whether the selling price for the product he is going to make will give an adequate return after paying corporation taxes?—When one is not considering the running of an existing concern but considering the raising of capital and the commencing of capital, then as it is the net amount of remuneration after corporation tax has been paid, if that has to be taken into account, to that extent it does affect the price of a project. It is rather marginal, not very large.

916. If profits and corporation taxes remain in being it would gradually be bigger and wider and wider?—Yes.

917. In fact in America today since corporation taxes have been levied for a considerable time, it is a definite element in price fixing of any new project brought on the market?—Yes.

918. Now, turn to this question of capital erosion, as you call it. Will the figures that you are going to produce attempt to differentiate the erosion that has taken place arising in regard to fixed assets and also in regard to stocks or working capital?—Yes.

919. And in that connection you have indicated that the general lines on which you are seeking to redress the erosion of working capital are through the L.I.F.O. and base stock system?—Yes.

920. Will your observations in connection with that deal with the problem of the erosion that has already taken place? In other words how do you see the base stock system being introduced now if 90 per cent. of the price rise has already taken place? How do you look upon that generally as being an effective instrument?—That is, Sir Geoffrey, a difficult problem because if you introduce a L.I.F.O. system when the prices are at the top and start sliding down, there is in fact no tax saving, clearly. There is a tax loss and industry could well say it has been pressing for this since before the prices rose and that it is not industry's fault if, when it is given, it might be at the wrong time. It is a difficult problem and that is one of the reasons why, in making detailed proposals, the objection should be given. I can myself

say immediately that one could not very easily ask that one should get in one year the whole of the loss through not having had the principle for the past ten years or more. I think that would be asking too much, to get the whole lot paid in at once. I do not think that is a practical proposition.

921. Mr. Carrington: One or two detailed points first of all, Mr. Chambers, just to clear them. You said in answer to one question that the fixed capital employed per worker has declined since 1938. Is that so? I was under the impression that if you measured it say by horse power per worker there was a greater number of horse power employed in industry per worker today than ever there has been in British industry.—Here again I am in the difficulty that I am relying upon evidence which has not yet been produced, but in so far as that evidence shows anything it does show for the sample taken there has been a substantial drop in the amount of real capital per head per worker; that might well be consistent with the increase in the amount of a particular kind of capital. It might very well be consistent with that.

922. You will probably look further into that point because it came as a great surprise to me when you made that remark. I would like you to examine it further.—Certainly.

923. The next point arises out of a previous answer. In discussing the problem with Mr. Kaldor of plant now in being that was in being before the war or pre-1941 purchases, you were assuming presumably that it was a once-and-for-all revaluation as in France and Belgium, that it would be that plant that would be looked at, the residue of the pre-1941 purchases?—Yes.

924. You expressed the view that relatively the figures for such plant are still high relative to the remaining plant in the workings and in the accounts of companies. Is that so as far as the tax position is concerned?—Mr. Kaldor was referring specifically to the comparison between pre-war and the present time. I think I tried to make it clear in relation to any particular asset in so far as there is replacement in 1946 or 1947 then, of course, the amount to be added on a revaluation is very much smaller than the amount to be added in respect of pre-war plant, but that does not mean that taking all assets together the sum to be added in respect of post-war plant put in in 1945, 1946 and 1947 may not be as great as the remaining plant that was erected before the war. That would require an examination of the figures.

925. Going one stage further from that answer, is it not a fact that the greater part of the pre-war plant will already have been written off?—That question I think Mr. Kaldor did ask and I think my answer is that there is much pre-war plant, a very large amount of pre-war plant, which is not written off, a very large amount.

926. Even after taking into account the additional allowances granted during the war as a result of overtime working and double shifts?—I think as the basis has been the written down value basis in respect of assets that bear only a low rate of wear and tear there would be quite a substantial block still left.

927. What sort of assets have you in mind in that answer?—Any long-term assets, heavy plant; in my own industry heavy chemical plant where the rate may be very low.

928. Anything carrying a basic rate of 7½ per cent. or over will have been substantially written down since 1939 bearing in mind the additional quarter, so that you have an effective 9½ written down apart from extra war-time running.—My arithmetic is no good and never has been, but I think if you take 7½ per cent. and increase it to 10 per cent. it takes the best part of seventeen to twenty years to write that down to 10 per cent.

929. There have been twelve years since 1939 now.—That means there are five years left in which the rate is too low; they are the vital years.

930. The figures for the last five are relatively small in relation to the whole, are they not?—Certainly, but this is the important factor; ever since the end of the war at least the rates have been substantially too low, profits have been over-stated from 1945 up to the present time, and for the next five years—

931. But if you dealt with this problem on a revaluation basis stepping up the written down value, there would not be much to step up on this residue of plant, would

there?—In respect of high depreciating assets the answer is there cannot be very much, in respect of lower ones there might be a lot.

932. There would not be very much in the case of the 7½ per cent. and upwards variety I should have thought.—I have not the figures, but they would require examination.

933. Coming to more general points I think you would agree, would you not, that the prime cause of the difficulty is inflation?—Yes, entirely.

934. Would you regard high taxation as anti-inflationary or deflationary?—I think that you cannot take taxation by itself, so much depends upon what you do with the proceeds of taxation. There are two points there. If you have high taxation and a large budget surplus, and if you cut down the basis of credit then in that sense high taxation can be deflationary. If on the other hand your high taxation is wholly spent so that it is spent by the Government instead of by industry or by consumer, then it is not deflationary. Indeed in such circumstances it can be inflationary by reducing productivity.

935. The points at which you are directing attack are two main ones, are they not, profits tax and the effect of inflation in relation to fixed assets and current assets?—Yes.

936. Let us take profits tax for the moment, the net yield of profits tax, that is the gross sum less the income tax relief it attracts. Is it less, I think, than the contemplated budget surplus, is it not?—I am sorry I have not the figures.

937. My recollection is that the gross yield of profits tax is about £10 million to £30 million, I am speaking from memory, I think that is not far out; so you get a net yield after income tax of somewhere about £150 million and that is, I think, less than the budget surplus?—If your point is that the profits tax is wholly saved in the sense that it is part of the budget surplus and therefore is deflationary, then of course that applies to any £150 million in the receipts part of the budget, and it is not therefore a good argument for having the profits tax rather than some other more equitable form of taxation.

938. You are putting an argument into my mouth that I have not put forward—I am sorry; I thought that was the point.

939. The question is this: looking at the problem from the standpoint of industry and the evil of inflation, which would be the more beneficial to industry, to cancel the profits tax entirely and reduce the budget surplus by a corresponding amount, or would they prefer to have such anti-inflationary benefit as is said to apply from a budget surplus. The cancellation of profits tax is quite the simplest form of giving the relief for which you are asking, the others, the inflationary points on fixed assets and stock, are not easy. I think you would agree cancellation of the profits tax only means one small clause in a Finance Act?—I can give my answer very clearly. In giving our evidence here our aim is to try and put forward points which will make the whole taxation more equitable and therefore we are not just saying "Can we have this relief or that relief?" We are saying that income tax should be on income and it should be of such a character as not to act as a disincentive. On both those points we feel that both these reliefs should be given. If you asked me not whether we would like to choose A or B but whether I regard one problem as more important than the other problem, I would say that in the short-term the inflationary problem is more important because it has an effect which is in implication much wider than taxation. I think the over-statement of profit is fundamentally bad for industry quite apart from the taxation angle. I think that it is in the immediate present the more important problem. If there were no inflation this problem would cease to exist and therefore it is a shorter term problem than the other. If you ask me which should be done as a long-term matter then clearly the profits tax must go. My answer is we feel that the inflationary element should be taken out of profits for tax purposes as an immediate matter. We feel that the profits tax should go as a permanent matter.

940. Would you extend that to saying that if possible, I underline if possible, the inflationary element should be taken out of profits for all purposes?—My own view is yes, it should be taken out for all purposes including distribution.

941. In the interests of the continuance of national productivity and prosperity?—Yes, very definitely and for price purposes as well.

942. And for price purposes?—Yes.

943. Coming now to the two bogies of fixed assets in relation to inflation and current assets, by current assets for this purpose I mean stock and work-in-progress...—Yes.

944. If industry had valued its stocks or prepared its accounts throughout on a base stock method, should we have been hearing the complaints which have been put before us to-day and on prior occasions that taxation is taking away something which is not true profit?—I think in so far as we are dealing with the stock aspect of the problem and not the fixed assets...—

945. Yes, for the moment with the stock and work-in-progress.—Yes. If we had a base stock principle, and if by base stock we were covering the whole of the stock and not a small proportion of the stock I think that it is substantially true. I mention that because sometimes this "base stock" principle is applied not to the whole but to a small proportion of the stocks. If you have it applying to the whole of your stocks and work-in-progress then substantially the trouble would not have arisen, I agree.

946. Would you say there was any legal bar to the adoption of the base stock principle?—I think the Income Tax Acts make no specific reference to the principles of the valuation of stock. I am not a lawyer but I think that is true. I think it is a question of determining profit according to sound principles, and if it could have been shown that the use of the base stock principle was unsound then it could be said to be illegal, or in a sense improper for tax purposes. I would have said that the case for saying that the use of the base stock principle was unsound or illegal is a very weak one, but it is a matter of some doubt on the whole. I think it is one of those matters where, if there is any doubt, it should be got rid of by allowing the taxpayer to adopt it.

947. Who allows the taxpayer to adopt it?—The Inland Revenue.

948. What has it to do with them?—I mean for tax purposes.

949. They are only one party to the contest.—I thought the question was whether for tax purposes it could be allowed.

950. Mr. Carrington: Yes, so it is—

951. Chairman: I think the point Mr. Carrington is putting is why the Courts should not be left to decide.

952. Mr. Carrington: I was leading to this point; have any taxpayers ever challenged the Inland Revenue on this and, if so, with what result?—This is now a matter of history. I do know from my own experience that the Inland Revenue over many years has consistently fought it and tried to get taxpayers not to adopt the base stock principle. If, in fact, their pressure, I say pressure, on industry not to adopt it was unsound, then I think industry possibly was weak in not resisting that pressure.

953. You have expressed in words the suggestion I was going to make.—Yes.

954. I do not think there is any accounting principle which would say that the adoption of a base stock method is wrong?—I agree.

955. Or, putting it in another way, would you agree it would be sound accounting to adopt it?—I am neither an accountant nor a lawyer but I think it would be sound; indeed, of course, in the United States either a L.I.F.O. or something like it is frequently adopted.

956. Some companies I think have actually, as distinct from whatever they may do with the income tax people, worked on it for a very long time?—Yes. I think I am right in saying for certain industries for a long time or perhaps to the present day the Inland Revenue have allowed it. It used to be allowed for certain industries many years ago; whether that is still so the Inland Revenue alone can give you the evidence.

957. If you are thinking of the same industry as I am I think the industry themselves actually asked the Inland Revenue to drop it with dire consequences to themselves. The point I wanted to bring out was this: does it really require a change in the income tax legislation to bring

about the adoption of the base stock principle?—No, I would say if I may about that if it became normal practice for companies to adopt a base stock principle or a L.F.O. method of valuation and it could be shown to be good commercial practice, I believe that could be the legal basis for tax purposes for those taxpayers. If that is so then no specific legislation would be required. I would add just this though, and this is an important and rather difficult factor with some companies where the amount of stock is large, it would not be easy for them to adopt such a method of valuation, cut down their profits by that amount and still pay tax on the larger method of computing profits, because they will have nothing left to pay dividends with. They would want the corresponding tax relief as well so that the two must go hand in hand.

958. I accept that. Before I leave that you are going to consider further this vexed problem and no doubt when you do you will look into the American elective basis and let us know what you think about it in principle and in detail?—Yes, we certainly will.

959. Coming to the fixed asset position, is not the problem—stripped of much of the wool that surrounds it—shall the taxpayer be allowed relief on the building up of liquid resources required to purchase the plant, or shall he be allowed relief when he spends the money, or shall he be allowed relief over the period of use of the new asset that he has bought?—That, I think, if I may say so, is a very clear way of putting it. If in fact for tax purposes there were no depreciation allowances at all but the cost of replacement were allowed in each case, the point would hardly arise, it would not arise. For certain classes of businesses that has been the practice. That is quite a reasonable practice wherever replacements are current and are not discontinuous. If you have replacements of an adequate or reasonable proportion of all the assets year by year in a very large business, then the actual cost of replacement year by year would give you for those years in question substantially the same as allowing depreciation based on replacement cost over those years. I would say that for those companies or other businesses where the replacement is discontinuous, where you have an interval of ten or twenty years and then a replacement, any method of giving replacements or any method which concentrates the allowance in the year of replacement is unsatisfactory because it over-states the profits for the earlier years. It does not appropriate to each year its proper proportion of the usage of the capital for those years.

960. You are speaking now from an accounting concept or from a taxation concept?—I meant whether from an accounting concept or, indeed, from an economic concept. I think the proper course is to allocate to each year the appropriate usage of capital for that year. I wonder if I could give an illustration to show what I mean, I think it is a very important matter. If you only allow the replacement cost in the year of replacement or, if I may refer to the example given in Mr. Tucker's Committee's report, you allow an initial allowance which concentrates the allowance in the year of replacement by entering the whole of the allowance in that year, if you do that and if the firm itself utilises the same method for its own accounting method, it will be over-stating the profits in those earlier years, then in the year of replacement you would require a substantial sum of cash which may not be available. If it is over-stating its profits in the earlier years it may be paying dividends and paying tax out of what is in effect capital; I think for that reason the concentration of the allowance in the year of replacement is quite unsatisfactory where the replacement is a discontinuous one.

961. Taking first of all the accounting aspect, it is a fact, is it not, that companies which proceed on this replacement basis do build up a replacement or renewals reserve over the years? They try to get an equated charge, then, when they spend the money, they charge it to that reserve?—What they do in effect is to say out of the profits for each of the intervening years a provision must be made by them, a provision or reserve for these purposes. It is a matter for discussion each year so that they do not regard as distributable any parts of the money required to maintain intact the capital which they have to replace several years hence.

962. Even if you do not subscribe to the economic wisdom of maintaining capital intact, is it not the fact that many companies and many boards of directors do, because of the very nature of their business, build up these provisions?—Yes.

963. And is it not the fact that such is contemplated under the Companies Act, so there is nothing new or novel in that method?—I think that is quite true, there is nothing new or novel in that method, no.

964. In fact it is the older accounting method of the two as compared with the depreciation method?—Yes.

965. But it is a method envisaged by the legislation governing public utilities and other statutory undertakings?—Yes.

966. So that if accountants had directed themselves on those lines in 1900 and if business men too had directed their minds on that and made their annual charges with due regard to moving price levels, we should not have had these pressed to-day probably?—Yes, and if . . .

967. I am coming to that point . . .—I agree entirely.

968. The point at issue really is, depreciation represents expired capital outlay, it is just a writing-off of that. The other concept is the build-up for the replacement?—Yes.

969. Those are the two methods?—Those are the two methods which tend to maintain capital intact so that you do not regard as distributable profits more than what is strictly available after maintaining your capital.

970. But if you proceed on the basis envisaged by the Companies Act of a provision for replacements, you would get a debit in your accounts directed to that end, and if that is properly calculated you may get your profits here more nearly right than you say they were.—Yes, certainly. I think that is a very helpful way of putting it.

971. With inflation, in the case of a business which only replaces every fifteen years, you would still have a problem at the replacement date if there had been a change in price level over that fifteen years, because your earlier provisions would have been inadequate.—Yes, I would agree entirely.

972. Looking at it from the taxation concept, do I rightly deduce this as a matter of principle from your evidence that what you are asking is this, that whereas in the past the Taxing Acts have granted an allowance on the wear and tear basis, wearing out, the expired capital outlay, you are now asking that an allowance should be given for the build up to replace that?—I think it comes to that, yes.

973. In other words you are asking for an allowance for a provision now being made in respect of expenditure to be incurred at a future date?—That is a way of putting it. I would say all along that the allowance, however it is computed, should be such that you take out of profits, whether for the purpose of distribution or for taxation, that amount which is required to maintain the capital which you have in the business, to maintain the productive capacity of the business.

974. I make a digression for the moment because of your answer; you would say that that should be done for tax purposes, and I am now dealing with tax, even though the expenditure is never incurred?—I would say yes, because I would say that there are some cases in which the exact replacement of the asset may never take place, and that the proper concept of income is what is left after you have maintained the capital. You may maintain that capital in the aggregate, but your intention may be physically to replace the same assets. Your intentions may never be carried out, but that does not get away from the general concept of annual income after you have provided for the appropriate usage of the capital during that year.

975. I think the only difference between us at the moment is that you say that you are providing for usage of the capital, and as I see it at the moment, I speak subject to correction, you are providing for the replacement of the assets you are now using.—Yes.

976. You would grant the allowance irrespective of whether those assets are replaced or not?—Yes.

977. I do not say replacing like for like, I appreciate owing to the change of industrial methods that you very seldom do replace like for like.—A simple illustration

shows that I think it should be so. If you have two businesses and each have three motor lorries and at the end of a certain period they have to replace those three lorries, it may be that the cost has risen to three times the original amount. In one case whether because of nationalisation or for some other circumstances beyond the control of the man concerned he is not going to replace. In the other case he does replace. There is no reason why in the computation of profits for the years concerned one should be charged differently from the other whether he replaces those assets or not. They are in identical circumstances, except that one is cut off from replacement and the other one is not.

978. So you do not accept the test of saying grant this allowance if the physical assets are replaced, but do not grant it if they are not replaced?—No, for the reason I have given, and having regard to the example I have given, I think that would be inequitable.

979. Have you any idea how much it would cost the Treasury to adopt that test?—No. I am sorry that although we are dealing with principles I am asked for estimates of cost of revenue for every proposal which is under discussion. I agree that it is an extremely relevant factor, but the exact cost is very difficult to estimate. The Inland Revenue have the machinery for estimating it, and it is not very easy for industry in putting forward proposals to work out the exact effect upon the revenue.

980. May I take you to a subject which you think very little of, namely initial allowances. If the rate of initial allowance is approximately equal to the increase in price as compared with the date of the purchase of the old machine and its replacement, does it not mean that immediately after the replacement the taxpayer has been granted relief of tax, or has been left with sufficient tax-exempted profit to cover the cost of that asset after he has bought it?—As a matter of arithmetic, of course, it is possible that the allowance given in the year of replacement will equal the sum of the allowance had he been given the replacement cost over the past years, but that itself is not a complete answer, for this reason, in fact two good reasons. One is that this tax method of dealing does not follow good commercial practice, and if the company itself, or the private firm, were distributing profits on that basis then you would not have the cash resources available. The second point is that the allowance bunched into one year in this way might be too much to be absorbed by the profits of that year. He may have been paying excessive taxation apart from excessive distribution for a number of years, and then get a tax allowance which cannot be absorbed, because the profits are too small to cover the whole of the allowance, and therefore he does not get the allowance until the loss is carried forward for several years.

981. That is assuming that the unit you are replacing is very large in relation to the total capital of the business?—Yes, it is.

982. In the case of most businesses that would not be so, would it?—For certain concerns such as mining concerns where the replacement element is very large in relation to the total capital assets that is true, that the thing to be replaced is large in relation to the total business. It is also true in the case of a small business where there will be great hardship by bunching the allowance in a later year only.

983. Do you mean because there are no profits available?—Because there are no profits available.

984. It can carry it forward, of course.—Yes, but then he may be bankrupt in the meantime, that is possible.

985. Is that just a theoretical possibility, or is that answer founded on fact?—I wonder if, for this purpose, I could give a little illustration, because I do think the figures are really such that the proposal to bunch all the allowance in the year of replacement is too much. To give an illustration, if you suppose that there is a company with, to give very simple figures, a profit of £300 a year before depreciation allowance, and the depreciation allowance amounts to £100 on the historical cost basis for a plant which costs £1,000, 10 per cent, using easy figures, and thus a net profit of £200. If the tax is, say, £100, this leaves a net distributable profit of £100, if that is assumed to be distributed, it may be the man is using it for private purposes, living on it. Then at the end of the life of this plant it is to be replaced at three times its

original cost it will cost £3,000 to replace, and the man will be short of £2,000 cash cost. The depreciation reserve of £300 each year for ten years amounts to £3,000, but he needs £3,000. If you give an initial allowance of 40 per cent, that I make to be £1,200, and if you have a 10 per cent allowance, that is another £300 on the £3,000, which leaves £1,500, the tax on that is £750, £750 is the tax, but his annual tax is only £100 a year in this case.

986. Why is that, if the value of the assets has gone up why do not the profits go up with it?—It may well be impossible to put the price up, it may be a controlled product. There are many cases like that.

987. Is not this example illustrative also of the fact that the major problem facing this man is one that is caused by inflation?—I agree entirely. His major problem is inflation.

988. Do you mean it would still be an element if he had no tax at all to pay?—In this particular case the example happened not to be quite happy, if he had the allowance on the replacement cost basis of £300 a year then his taxable profit would have been nil and he would not have £3,000 at the end of ten years which is the amount required to replace the plant.

989. Two minutes ago you were saying he would have had nothing to live on, so presumably he would have gone out of business?—It could have demonstrated that the price of his product was too low, and there are cases like that.

990. That brings me to my last point. In your submission regarding provision for renewals, I prefer to call it that to depreciation because it is not depreciation if you look at the dictionary meaning of the word depreciation, do you visualise using that for all commercial purposes?—You mean fixed assets other than the manufacturing industry?

991. No.—For other purposes?

992. Yes.—My answer will be yes.

993. Would not that be inflationary?—On the contrary I think it would be deflationary. It would certainly have the result in some businesses of reducing the distribution profit.

994. Would it not have the result of pushing up prices?—It may very well have the result of pushing up the prices where certain prices are uneconomically low, and there are cases like that where the price has been kept down by reference to net profits and by reference to depreciation on historical cost, and in some cases the price is, in fact, too low and should be increased. In such a case the increase in price is not inflationary but is justified and necessary to maintain a proper balanced production.

995. Would it have an inflationary effect on the general economy of the country?—I would say no, because if you get a more balanced production then you get higher productivity, and no further inflation. A mere increase in prices is not in itself inflationary.

996. Is it not?—Not by itself. If, in fact, the only thing that happens is an increase in prices, that is not necessarily inflationary.

997. Does it stop there? If you increase prices does the movement stop there? Do you not get claims for increased wages?—We are getting a little beyond the ordinary tax allowance, but I would say at once if your central credit policy is right no such spiral would take place.

998. Mr. Carrington: I would need further argument on that from my economic colleagues, but I have my own views.

999. Mr. Milford Tucker: (Mr. Chambers, I will give you a rest for a moment, and I just want to ask you one or two questions on the matters upon which you have dealt in this paper, because I am afraid that a good deal of the discussion this afternoon is really concentrated upon a new paper that you are going to produce in due course.—Yes.

1000. It may be useful for you to know how you ought to deal with some of the points in detail when you come to your new paper, and I have no doubt Mr. Bower will also take note of the sort of questions that have been put this morning.—Thank you very much indeed.

1001. I want to ask you particularly if you can help me a little. In this paper you are dealing with the effect of the present system of taxation so far as it affects incentives?—Yes.

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[Continued]

1002. How far it encourages or discourages, or prevents or promotes, savings and so on, that is the sort of point?—Yes.

1003. What I would like to know is something about this disincentive effect of P.A.Y.E. I have no doubt you have read, as I have read here and there in the Press, statements, how far they are accurate or not I do not know, that it has a tremendous disincentive effect particularly in some industries, that it contributes towards absenteeism, because by being absent on a particular day a man will get a tax refund, and thereby think he has got a financial benefit. I do not know whether you have any further knowledge on that. Perhaps like myself you have read about it from time to time in the papers or have heard indirectly from perhaps your wife who has had it mentioned to her by the same lady who obliges who refers to some relative of hers, and the effect on him or her, but do you think you could produce before us a real witness who has actually been affected in this way, and would actually tell us why?—That is an extremely difficult question, if I may say so, and I would say this, that this is a matter which I discussed with my colleagues in the British Employers' Confederation, and they made an intensive study of this, a very intensive study, because of the conflict of evidence, and, if I may say so, I think that their evidence on this will be much more valuable than mine. I think they have gone into it most thoroughly.

1004. Chairman: Perhaps you would pass on the suggestion to them, that they should produce a concrete witness.—I will.

1005. Mr. Millard Facker: I entirely agree with you. I thought you would probably say that. You may only see this matter from some distance, you are not in close day to day touch with the people who are said to be affected, and what I am asking you is whether you can assist the Commission in getting somebody of the class who is said to be affected to come here and tell us frankly how far and why it affects him and his colleagues.—Yes, I think that something like that should be done, and I think it could be done. One of the great difficulties is this question of the incentive, and what I have noticed in an examination and also in that by my colleagues in the British Employers' Confederation is this, that so often on detailed examination the case breaks down: the reason given is a taxation reason, but the real reason is something quite different, and so often the taxation reason is a secondary or tertiary reason. A man wants to go to a football match or something, and he wants an excuse, some other excuse to have time off or not to work overtime, and what he says is, "It is not worth my while working overtime because of taxation". When he is examined in detail, and I have done so on this, it is found that the taxation reason is not the real reason. I think, if I may take the suggestion, the production of at least one concrete witness would be of value.

1006. It would certainly be of value to me. I do not think my colleagues would object to hearing one either.—Yes, with great pleasure I will do what I can.

1007. You and Mr. Bower between you and the Employers' Confederation as well, we could perhaps have one or two?—Yes.

1008. I do not trust anything I hear secondhand, and it would be wrong to try to form a judgment on such secondhand information. I will not say any more about that. In paragraph 15 of your memorandum, and also in paragraph 24, you put forward the view that the present structure of taxation is wrong, and that there are too many jumps from one scale to another. You say that at the moment you have not made any concrete suggestion as to how to overcome that.—That is the position.

1009. Do you subscribe to the view that it would be good to start making people pay income tax at a comparatively low income, or at almost an income which would, say, be equivalent to the cost of living?—I would subscribe to such a thesis. I would say just this, that I believe that any reform would aim at making the taxation from that level up to some other level very simple as in the United States.

1010. Yes?—So that we do not attempt to apply to, I think it is nearly 20 million, or 14 million or 15 million taxpayers not a system which was intended to apply to 2 million or 3 million.

1011. No?—And in respect of this great bulk of wage earners and salary earners I think the incidence should be the same as for other people of the same income, and the method that we adopt at the present time of applying very complicated income tax rules to each case is, I think, wrong. I think that what should be done is to aim at something which is much simpler, and which does avoid this big gap between the average rate of tax and the marginal rate. There are so many cases in which the net amount of tax payable is trivial and yet the marginal rate of tax may be very high and in which the amount of work is altogether incommensurate with the amount of tax collected. In other countries, in Germany and the United States, they have endeavoured to take that big block of low incomes and deal with it on rough and ready lines. I think our attempt to be scientifically accurate with these small incomes really breaks down, and we do not reach a true degree of greater equity. All we succeed in doing is to cause an immense amount of work to the Inland Revenue, to employers and employees to get a result which, from the employer's point of view, he does not understand. It is just that we are aiming at something which will be simpler.

1012. I am rather interested in this view. What is your view? Is it better to make sure that as many people as possible pay income tax based upon their incomes, because it is a good thing to make people realise that nothing comes out of the State unless they help to pay for it, or would it be better to have one standard rate of tax, leave out surtax for the moment?—Yes.

1013. One standard rate of tax and make that apply only at a comparatively high figure?—I would personally much prefer the first system, both for the reason which you mentioned, because of the greater sense of responsibility, and for another reason, that alternative forms of tax which are imposed do tend to be regressive, and to impose what is in reality a heavier and not a lighter burden on lower incomes. The tobacco tax, and other taxes, if they are examined very carefully, and in some of the purchase tax cases, these fall very heavily on small incomes.

1014. But they are voluntary taxes, Mr. Chambers, are they not? No-one need smoke, no-one need drink, at least alcoholic liquor, and they need not pay the tax?—Not being a smoker I can easily subscribe to the view that it is voluntary, but having seen and discussed the matter with friends who do smoke I think the suggestion that they are voluntarily paying the Chancellor of the Exchequer a lot of money every year is a view which they can never subscribe to.

1015. Nor do I. I would call it a compulsory tax as far as I am concerned, but it is, in fact, a voluntary tax in the sense that you need not pay it unless you want to?—It is true I think of the tobacco tax, it is true, of course, of the tax on spirits, and it is probably not true about some of the purchase tax.

1016. Some of them, yes?—You have to dress and so on.

1017. You can have utility suits, can you not?—Yes, on the whole though, I think in practice whether it is voluntarily paid or not the effective burden which has in fact to be paid and comes out of the income does tend to be very high in the lower ranges.

1018. Your view would be that it would be better to have tax started at a comparatively low figure of income, and somehow to simplify the lower ranges?—Yes.

1019. Are you going to give us any suggestions on simplification in that way?—We are hoping to do so, yes.

1020. That is the paper you mentioned to the Chairman that is also on its way?—Yes.

1021. You made some reference in paragraph 40 to the question of annuities. It is the age-old complaint that if a person buys an annuity what he gets back is purely capital and partly income. We are dealing with this subject in this other Committee in which we are dealing with pensions and so on, but while you are here have you thought of this difficulty? I will emphasise it by reminding you of the present position. It is possible today to go to an insurance company with a sum of capital and buy yourself what is known as a *split annuity*, that is to say part of the annuity, every weekly or monthly or yearly payment of the annuity is agreed by all persons including

the Inland Revenue to be capital, and upon that you do not pay any tax at all. You only pay tax on the balance, which represents really the interest. Of course, that can only be done with a terminable annuity?—Yes.

1022. How would you deal with a case of a life annuity on that basis?—I think the difficulty with the life annuity, as I see it, is this, that when you start you do not know how long the annuity is going to last, and therefore you do not know in advance what position is going to be income and what is going to be capital. The insurance company from its point of view can average and can say that taking all lives together people die with a remarkable regularity. As they die with a remarkable regularity therefore they can say in respect of different classes just exactly how much is income and how much is capital for their purposes. I believe the only solution would be to take in respect of each such annuity the amount of capital and apply to it some agreed life table and say of the annuity paid so much is capital and so much is income in respect of a given period.

I have not gone into this; whether it should be so designed that the capital element comes to an end at a terminable date so that the remaining part is income, or whether it should be so designed that it will never come to an end until the person dies. I think the first method would be a reasonable one if, in fact, a person bought an annuity with an expectation of ten years and lived sixty years then it is reasonable to say that the capital he has paid in is exhausted and after ten years or so the whole of the remainder is legitimately regarded as income. I do not think such a person would complain.

1023. In practice no one would get an annuity on a ten years basis who is likely to live to sixty.—I was exaggerating, but I think that my point was rather if one could get a formula then it would have to apply on a basis which looked forward on an expectation of life.

1024. Your answer is you do it with life tables?—Yes.

1025. Everybody to take it on their life table?—The only other way is to do it after the event.

1026. On the footing that they are all first class lives?—On the footing of the life which was taken into account when the amount was given. It may not be a first class life. The annuity may be granted on some other basis, I do not know. I think that is the way to deal with it, but it is an extremely difficult subject, and if another method were devised I think it would be worth consideration.

1027. In the course of discussion this morning somebody asked you a question about the adoption of the current year basis, that is to say the matters which we dealt with last time.—Yes.

1028. I gather that your answer was that still another paper is coming on that subject?—Yes.

1029. You no doubt read the Report of our first Committee?—I did, yes.

1030. And you may have noticed in it that we emphasised the way we approached the matter. In paragraph 66, the second sentence, we say:—

"We began our consideration of the problem with a strong predilection for a change to some form of current year basis, and with the help of the Board of Inland Revenue we laboured long in an attempt to find a solution."

Indeed we did.

"In the end we were driven to the conclusion that, whatever may be the experience of other countries whose size and circumstances differ greatly from those of our own, a current year basis is impracticable in this country."

We gave some of the reasons for that in the body of the Report, and I wanted to remind you of that, that you were then preaching, as it were, to the almost converted.—Yes.

1031. And it was only practical difficulties which prevented our finding any solution that was satisfactory for us to put forward as responsible people.—Yes.

1032. In your current paper can I ask you to deal with the difficulties without fail that we put forward, and will you kindly remember one important factor in doing that: that is this, that you, of course, are representing the Federation of British Industries, Mr. Bower is representing the Association of British Chambers of Commerce and then there will be a few other people, the National Union of Manufacturers and other associations of similar kinds. Now I hope you will not, when you make up your new paper, concentrate too much upon the larger companies, because there is a tendency, we have been doing it all the morning as I have been listening to the discussion, to talk always about companies, and you will remember that we pointed out in the Report that every year there are 1,500,000 Schedule D assessments to be made. Of those only 200,000 are on companies, about 200,000 are on partnerships and 1,100,000 are on individuals, so the companies are 200,000 in number, and partnerships and individuals which really go altogether are 1,300,000. Now then, so as not to distort the picture, the White Paper of 1951 gives these figures of profits: companies' profits £1,795 millions, and individuals and firms £1,329 millions, so they are very substantial. The difference is not so great in figures either, but it is a very great difference in numbers. What may be very satisfactory, I suggest, for a big company will be very tiresome for an individual. I should find it tiresome for my own purposes. I have no doubt many doctors, dentists and farmers would find it equally tiresome to have two or three assessments in respect of one year. All I hope and ask is that you will adequately deal with those difficulties, and especially in view of the fact that some of these self-assessment systems must cause a great deal of extra work. I merely mention that to you without asking you any further questions about it now I have heard you are producing another paper.—If I may say so, we have gone into this, and we are going to do it with great care, because we did realise that obviously the whole matter had been very carefully looked at and sympathetically considered.

1033. Sympathetically certainly.—And that the thing to concentrate on was the complications and the administrative difficulties, and not the principle. I believe there are certain answers to some of the difficulties. We believe that we shall be able to produce answers to some of them, and then to show that some of the others are perhaps not so great even for small businesses. That question we have well in mind, because the small business is a business that needs the greatest assistance on these things. The large company can cope with any system however bad.

1034. I would only ask you also in doing this to remember what you well know yourself, the Indian system.—Yes.

1035. The Indian system takes the actual income of the year and taxes it in the following year.—Yes.

1036. To all intents and purposes we do the same, but there is a subtle legal technical difference in the matter, is there not, that in this country in theory you tax the current year's income and measure it in respect of some profits by the preceding year's income.—Yes.

1037. If you have a business and you have a salary employment at the same time you have two separate years' income to give.—Yes. We will certainly bear that in mind, and also the Indian system.

1038. Do you find anything wrong with the Indian income tax system? The only difference as far as I can see is the man does not know as he is going through the year what the rate of tax will be because it is not fixed in India for the following year.—That is naturally a difficulty, but it is not really essentially a difficulty that you cannot overcome in any case in which you are collecting the tax after the end of the year. It is the same problem.

1039. That is the same position as you have with business profits, you go on making your profits in the Year 1 and you do not know what rate of tax is going to be applied to them because it is not known until the beginning of the Year 2.—I would say, if I may, the Indian system of assessing the actual profits and collecting tax after the end of the year is obviously the simplest system, and the only difficulty in adopting that system is the difficulty of the changeover from one system to another. That system does avoid all the commencement and cessation problems and the partnership problems. The whole difficulty is in the transition.

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[Continued]

1040. I think there are some more difficulties. However, we will not go into that any further. We will wait and see what you have to say by way of something more considered. With regard to the discussion you had about stocks which is part, of course, of the inflationary problem, did you know that a case has been before the Special Commissioners in which a company claimed to adopt the basic stock system and succeeded?—I have heard rumours, but I am not very much in touch with other cases.

1041. The decision was rather based, I think, on professional accountancy evidence, that evidence being to the effect that in some businesses it is equally proper in arriving at your profit to adopt a basic stock method of valuation as it is to adopt a different method of stock valuation, and since each are accurate each must be in accordance with accountancy principles, and therefore either must be right whichever the man chooses to adopt, but he must be consistent. However, I understand the matter is going further.—Yes.

1042. So we shall see whether the Courts confirm that view or not—I think if that view were confirmed, and if that judgment were related to similar systems of valuation, I mean not necessarily based on exactly the system adopted by that particular concern, but to other methods, the LIFO method is adopted in the United States, and if therefore it became legal for a taxpayer to adopt these methods then no question of legislation would be involved in changing to what would be from industry's point of view a more satisfactory method.

1043. Do you remember that a little while ago, some years ago indeed during the war, the Privy Council said in an Indian income tax case that it really did not matter on what basis you valued your stock so long as you had the same basis both at the beginning and at the end of the year—I am acutely aware of that case because it involved a gap at the point of changeover which was, I think, quite disastrous for the Indian Revenue and, indeed, when they had the judgment they would have preferred to have lost rather than won, because they lost far more money permanently on that basis than they would have made if they had not taken the case to the Courts.

1044. That often happens. Now just a word about foreign business income. I think you actually refer to that in your paper. You were talking then of a company or a person resident in this country carrying on business in a foreign country.—Yes.

1045. And assuming there is a double taxation agreement between the two countries, the effect is, is it not, that he pays tax on the whole of his profits at whichever is the higher rate?—Theoretically that is the effect, but in practice because of the inter-relationship of this problem and that of the basis of assessment in many cases the total tax bill is higher than that because relief is not available on the whole profit. That is a very common problem.

1046. I know there are technical problems that bring that about, but I was talking rather generally.—Certainly.

1047. What you say is that in such a case so far as British tax is concerned that business should not pay any tax except upon such amount of profit that it actually earns to this country?—Yes.

1048. What is the real reason why you say that is a just and proper result?—Again I am certainly thinking of companies in this case, small businesses hardly ever operate on such a scale as to make the problem an important one.

1049. Mr. Carrington: Some partnerships do.—Yes, some partnerships do, some professional partnerships do. I have just recalled that.

1050. Mr. Melford Tucker: I have a victim beside me here—I think what I say would apply to them, but in so far as a company has distributed its income to shareholders in this country there is income arriving to those shareholders upon which they should pay tax, whether that income has arisen in the first instance abroad or anywhere else. In so far as profits are retained overseas frequently that is required for the maintenance or extension of a business or to cover losses or to do something to keep a footing in that country. That does not really inure to the benefit of the shareholders until the profits come over here to Britain. But by exempting the sums put to reserve overseas, that is to say, profits retained overseas out of overseas activities, we would sweep up a lot of problems which would otherwise arise in so far as

there are inflationary elements included in those profits or the measure is arbitrary owing to currency troubles. Moreover, in so far as the profits are not in any way available for transfer and in some cases even the capital is in jeopardy, there is no taxation on somebody here who has not been able to bring his profits home or use it in any way whatsoever. So long as the property and the income in the property remain in the foreign country we suggest the burden of taxation should be the foreign taxation, but that when it comes home and is available as income to the true owners, at that point it should be taxed. It is not available to the owners as income until it gets here.

1051. The case you are putting is that of the company which is carrying on business wholly or mainly in a foreign country?—Yes.

1052. The profits it has got in the foreign country are still available to it in the area of its business, are they not?—Yes, but if one is considering a company which is British registered and has part of its business overseas. I do not mean wholly or mainly overseas, but some branches overseas, its main business may be in this country, I am still considering that case, if its stockholders are in this country there is a reasonable presumption that if it cannot bring home the money that is made overseas it cannot distribute that as dividends to its stockholders. So far as it does distribute profits from an overseas register then, of course, the question of taxation of the stockholders who live in this country is already taken care of under the income tax rules.

1053. That still does not, at least to my satisfaction, answer the question. I do not care whether you take a company which is carrying on business wholly abroad, mainly abroad or mainly here and partly abroad. If it makes profits abroad then those profits represented by whatever assets, it may be in money, stocks, buildings, plant, are available for its use in the area in which it operates.—Yes.

1054. And the position of the shareholders of that company at that stage is quite immaterial, is it not?—Well . . .

1055. Wait a minute, is it or is it not?—I do not think it is immaterial, no, I would not say it is immaterial.

1056. I will accept that, it is not immaterial. Take the case of the ordinary English company carrying on business wholly in Great Britain. It makes profits, and because of its own financial requirements it says, "I cannot distribute very much profit in dividends because I want the money for use in the business." It has its profits for use in its business, has it not?—Yes, true.

1057. Is the position of the shareholder immaterial, or would you say because the shareholder cannot get some of those profits you ought to relieve the English company as well?—There are certain cases in which, of course, the position of the shareholder of the English company is taken into account. I am thinking of non-distribution of profits. Beyond a certain point you say if this company has not distributed its profits we shall deem it to have distributed its profits.

1058. I am not talking about deeming under Section 25, Finance Act, 1952, but the ordinary public company which makes a profit. It has got to retain the money which that profit represents, or which represents that profit in its business since it cannot afford to get rid of it for ordinary commercial reasons, therefore it does not distribute it. There you say, "I do not see any objection to taxing the company on the whole of its profits, although it cannot distribute them." In the case of the foreign company you say, "I do see a reason why it should not be taxed on the whole of its profits, and the reason is because it cannot distribute them."—Because it is not even brought to this country and made available to the company at its own headquarters. I admit the two cases are so similar that logically if there is a claim for exemption in our case it would appear to apply to the other. I wonder if I might put the point in a somewhat different way because I think it becomes clearer. The British Revenue does tax all the profits made in this country not only by British companies but by an office registered abroad and a person registered abroad if the profits are made here.

1059. Yes.—They say it is right and proper to tax all those.

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1060. Yes.—Even though the persons are resident overseas and even though the persons may be subject to their own tax overseas. They also say, "We will tax not only all the profits that arise in this country wherever the person is resident, but also tax all the profits that arise in persons resident in this country wherever the profits are made". In other words, we do not say that we choose one basis for taxation or the other, we choose them both, and in choosing both, we then go to the position of double taxation and therefore get all the troubles that arise from double taxation. I think if profits were completely remittable, if the question of double taxation did not arise, and if there were no currency problems of any kind so that one country remained about the same as the other, this problem would be unimportant, but there is double taxation and there is that difficulty. There is also the other point which I have mentioned that companies, say, American companies may be competing with British companies in Africa and therefore it may be necessary to retain their reserves over there and having a heavier burden of British taxation on undistributed profits and reserves may well put those British companies at a disadvantage in comparison with the American companies. I would not put it higher than that.

1061. Does it hold down to this though, that you advocate relief of British companies trading abroad on the part of their profits which is not capable, or, in fact, is not indeed remitted here simply on economic grounds?—Mainly on economic grounds plus double taxation grounds.

1062. When you say "plus double taxation grounds" that is somebody else's taxation you are thinking of not ours?—Yes, but the fact that there is that same measure—those profits may be taxed by another authority, and linking that up with the fact that it does seem reasonable that each country should be entitled to choose one basis or the other and that one country should not choose both bases to the detriment of other countries.

1063. I do not follow that, I wish I could, because I am really asking for assistance from you here in putting a really sound substantial argument, an unanswerable argument, as to why British companies carrying on business abroad should be relieved from tax upon any part of their profits that they do not remit here. You see, so far, you said that you asked for relief on economic grounds. I can understand that.—Yes.

1064. It is desirable that British industry should flourish abroad?—Yes.

1065. That is what you mean, is it not?—Yes.

1066. You did tell Mr. Crick this morning that you strongly abhorred the bringing into tax consideration of any economic objections at all.—I think I did qualify what I said by saying, using the instrument of taxation as a differential method of encouraging one thing rather than another within the country, I do not know whether I used those words.

1067. You did not use the words "within the country" because I was listening very carefully, but I am not trying to catch you or to make a debating point of it. I am one of those who do not entirely subscribe to the view that economic views must be left out of it altogether. I think they must be kept in view at the same time, otherwise you may have other troubles, but however that may be, what I want is the unanswerable argument that British companies trading abroad should be relieved of their liability to tax, and the first reason you give me is, as I can well understand, on economic grounds, namely that we want British industry to flourish abroad and increase abroad. In fact, that is what everybody is talking about at the moment, increase your exports, and that is an export, the carrying on of business abroad, is it not?—Yes.

1068. Now you add to that a second reason which I frankly do not follow. It may be, no doubt it is, that I have not followed what you said, but you say on double taxation grounds. I will tell you why I do not follow it. If you are operating in a country where there is double taxation relief you will get some relief if not the full relief on the profits which bear tax in both countries.—Yes.

1069. In so far as you do not get proper tax relief the excess foreign tax which is not relieved is treated as a trading expense?—Yes.

1070. That is right, is it not?—Yes.

1071. You get some relief but not quite the full amount. What is left in the double taxation field that helps you argue?—I think it is a difficult matter and, if I may say so, I very much appreciate the difficulty, because the arguments are not clear cut, but the economic argument is very much linked with the double taxation argument in this way, and I think I can put it quite simply. If other countries, such as the United States, say that in respect of income arising in Rhodesia; "We will leave the Rhodesian Authorities to apply income tax to that because we think it right and proper that the United States should not have a double basis of taxation and collect everything from everybody", and if other countries say the same, if there is a general understanding that you adopt one basis or the other, but not both, it seems, shall I say, unfair that the British tax system should go wider than that and in respect of, say, a concern in Rhodesia the South African concern and the Australian concern and all the other concerns should only pay tax at the Rhodesian rate but that the British concern should pay at a higher rate even if it has got full double taxation relief. It does seem that that is unfair. You may even say it is not a taxation principle, and the other people ought to charge as much as we are charging. I would say it would be better if we fell in line with the other countries and reduced the basis of our taxation. I might go on to say, if I may, that in some countries, of course, the whole profit is relieved of tax whether remitted or not. We have not gone in our recommendations quite as far as that, but there is possibly a case for going still further, perhaps more logically than for stopping there at the moment. There may be a case for going further than we have done.

1072. Is it right to say what you are asking for is really to go back to the very first principles upon which income tax was first imposed?—Yes.

1073. In the days of what we call the "Plantation abroad"?—Yes.

1074. And that every foreign trade should be considered to be a foreign possession and that income tax has never, in the whole history of income tax, been imposed upon a completely foreign possession except on the basis of remittances?—Yes.

1075. I think you are on sounder ground, there you know.—I think we probably are on sounder ground, yes, on that basis.

1076. I was hoping you might be able to give some extra support to the argument rather than say we should alter history.—I think the question of the comparative system of taxation gives you an answer, but this is a subject, I have said this several times today on other subjects, which comes in the list of points on which you have asked for supplementary detailed proposals and what we would like to do, in the light of what has been said today, is to submit detailed proposals and possibly detailed arguments reinforcing what we have already said, and if you feel that we ought to strengthen our case and claim exemption of the whole profits made abroad instead of only part we might....

1077. As your case is put, Mr. Chambers, it did not appear to me, with all respect to you all, that it really provided sound arguments for what you are asking for.—It provides an argument for more than we are asking in a sense. I think we ought perhaps to look at it in that light.

1078. Mr. Millard Tucker: Perhaps you will between now and tomorrow morning be able to think of something else.

1079. Chairman: I was rather hoping we would finish this business tonight, because we have the Association of British Chambers of Commerce and the National Union of Manufacturers.

1080. Mr. Millard Tucker: Mr. Carrington has asked a good deal about this replacement cost question, and I could have asked you a lot more questions myself, but again this is not a subject matter, I notice, which really should have come up at all at this meeting.—No, that is true.

1081. And I gather that both you and Mr. Bower's Association are in the course of producing a new argument on replacement costs which was not before the first Committee?—That is true, yes. I thought that today you wished the general principles discussed.

1082. That being so I do not think I will take up any time in asking questions on the old basis. I will relieve you of any further questions from me, that is all I wanted to ask you.—Thank you very much.

1083. *Chairman*: There are one or two questions I want to ask you arising out of the questions that various members of the Committee have put. The first two, I think, are based on this. You have said that what the Federation desire to bring before us are proposals to make taxation more equitable?—Yes.

1084. There are two matters which have arisen, on which I shall want further elucidation in your subsequent memorandum, and the first is on L.I.F.O. I am in a little difficulty, and I will put it this way. The primary duty is, according to the Companies Act, to produce a fair statement of the companies' profit. I am at present not completely clear in my mind how the L.I.F.O. method in the case of one company can show that while the F.I.F.O. does it is another. If you are going to ask that companies should have the right of electing which they choose *prima facie* it looks to me as though they want to get the best of both worlds and the Revenue get the worst, and so the memorandum when you put it in should it be possible to do so displace that *prima facie* impression.—Yes.

1085. The second point is this, and it arises out of what Mr. Carrington put to you. He was talking to you about replacement, and if I understand that, and I am not sure that I do, that means that there is a reduction in arriving at taxable profits of the whole of the expenditure in the year in which it is incurred?—Yes.

1086. That may work all right as regards companies, but might not that produce peculiar results applied to individuals and partnerships in its effect upon the surtax position, and might not that possibly be a reason for preferring your method to Mr. Carrington's replacement method?—I would say, Sir, that even for companies where there is a discontinuous method of operation of replacement if it only occurs once every 15 or 20 years for bulk assets even in that case I think it is unsatisfactory.

1087. As Mr. Tucker said I do hope that when you come back again in that respect also you will not confine yourself so entirely to companies. Two other questions only: in reply to Mr. Crick you said that you already had experience of cases where the physical assets were not being maintained. On that point you are going to write us further?—Yes.

1088. But I suppose you will take care in putting in your subsequent memorandum to make sure that you do not include cases where failure to keep up the physical assets has been due not to shortage of finances, but to shortage of materials, because there must be some replacements which have been missed because licences could not be obtained, or through shortage of materials, rationing has made components in short supply but one wants to omit that kind of consideration.—I think we can do that, because for the examples that we were referring to that point would have shown in the existence of large amounts of unspent cash, and I think we would show that that is not so.

1089. The last point is this, in answer, I think it was, to Mr. Crick, it may have been to Mr. Kaldor, you said that you would like to see the profits tax abolished, and you recognised that that would involve a transference of the revenue derived from profits tax to personal tax.—To some other tax.

1090. It would be tax on everyone, individuals as well as companies, it would take the form of an increase in income tax.—I think that is an inevitable consequence, if I may say so, if it is to be linked to present direct taxation which I think are the terms of reference.

1091. *Chairman*: To be considered in this commission, fortunately perhaps. The amount involved in 1950 was £260 million. That means an increase, if you raise it only to that, of from 1s. 9d. to 2s. in the pound. Now does not the psychological factor come in? Would not there be resentment by the individual who found 1s. 9d. tax put on?

1092. *Sir Geoffrey Heyworth*: It is gross.—Roughly half of that.

1093. *Chairman*: Only half, but even so the psychological factor might come in and the Government would have to consider whether the burden of taxation was not more readily absorbed through the impersonal company instead of 9d. in the pound on the individual.—May I answer that by saying if a tax is imposed, such as profits tax, and we regard this as a bad tax, and it has been imposed for several years, we find it a little hard to have the argument put forward that although we regard it as bad and unsound, perhaps it cannot be taken off because, if it is taken off, some other burden has to be put in its place.

1094. The psychological effect and the disincentive effect on labour, salary and wage earners, might be such that although the profits tax might be bad the disincentive effect on work might be worse. That is a consideration.—We did consider all this, and that is one of the reasons why we said that it is so much easier to consider making the taxes more equitable if at the same time there is a reduction in taxation. It is so much easier to do that. The terms of reference which relate to the maintenance of an extremely high level of taxation make it most difficult to deal with the matter in a suitable manner. That is the difficulty we are in, we are in great difficulty.

1095. *Mr. Carrington*: There is one additional point I would like to be included in these further points about the running down or otherwise of cash resources and the maintenance or otherwise of fixed capital. Would you take into account the restitution of war damage?—Yes.

Chairman: We are very much obliged to you, Mr. Chambers, and your colleagues. I think we owe an apology to the representatives of the Association of British Chambers of Commerce for having them kept here all day and not having given them a chance, but we will resume at 10.30 to-morrow morning.

The witnesses withdrew

MINUTES OF EVIDENCE **5**
TAKEN BEFORE THE
ROYAL COMMISSION ON
THE TAXATION OF
PROFITS AND INCOME



FIFTH DAY

Friday, 2nd November, 1951.

WITNESSES

MR. F. BOWER, C.B.E.

MR. F. M. GILLIAT,

MR. W. J. LUXTON

} The Association of British Chambers of Commerce
Questions 1096-1432

MR. W. R. CLEMENS

MR. F. T. JACKSON, O.B.E.

SIR LEONARD BROWETT, K.C.B., C.B.E.

LT.-COL. V. I. ROBINS, O.B.E.

} The National Union of Manufacturers
Questions 1433-1509



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TERMS OF REFERENCE

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages: to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer: to consider the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden fairly among the individual members of the community: and to make recommendations consistent with maintaining the same total yield of the existing duties in relation to the national income."

NOTE

For the guidance of intending witnesses the Commission published a list of the main heads under which evidence was invited. They explained that the list was not necessarily exhaustive and that witnesses could put in evidence on questions not specifically mentioned, provided that they fell within the Commission's terms of reference. The list is reproduced below.

A. General social and economic questions

1. Is the present system of taxation satisfactory, or could it be improved, in relation to:—

- (a) incentives,
- (b) risk bearing,
- (c) encouraging savings,
- (d) the control of inflationary or deflationary tendencies,
- (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment,
- (f) its effect on the distribution of personal incomes,
- (g) other economic and social objectives?

These questions can be considered in relation to the taxation of:—

- (i) salaries and wages (P.A.Y.E.),
- (ii) profits of businesses and self-employments,
- (iii) dividends and other sources of income.

2. Would it be advantageous to link Income Tax with social security payments and contributions?
3. Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

B. Particular matters

4. Is the taxation net drawn too widely or too narrowly in relation to:—

- (a) the taxation of United Kingdom residents (companies or individuals) on overseas profits,
- (b) the taxation of non-residents on United Kingdom profits,
- (c) the definition of residence, etc.?

5. (a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particular—
- (b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?

6. Is the basis of computing income from property under Schedules A and B satisfactory?

7. Should the present rules about deductions for outgoings and expenses be altered?

8. Are the provisions for relief in respect of double taxation satisfactory?

9. Should the present system of graduation by means of the exemption limit, personal allowances, reduced rate relief and Surtax be altered?

10. Should the existing differentiation between earned and unearned income be extended or reduced?

11. Are alterations necessary in the rules governing personal and other allowances?

12. Should the rules about the taxation of husband and wife be altered (a) as regards aggregation; (b) in any other respect?

13. Should P.A.Y.E. be altered or abolished?

14. Should the principle of deduction at source be extended or restricted?

15. Should the method of assessment to Surtax be altered, and in particular should it be deducted from salaries?

16. Are any alterations desirable in the system of administration and the functions of the various statutory bodies or persons connected with taxation?

17. Are any changes in the provisions against avoidance and evasion desirable?

18. Is any alteration necessary in the rules governing the taxation treatment of special classes of taxpayers (e.g., public corporations, co-operative societies, charities)?

THE ROYAL COMMISSION ON THE TAXATION OF PROFITS AND INCOME

FIFTH DAY

Friday, 2nd November, 1951

PRESENT.

The Rt. Hon. LORD JUSTICE COHEN (Chairman)

Mr. H. L. BULLOCK
Mr. W. S. CARRINGTON, F.C.A.
Mr. W. F. CRICK
Mr. HARRY GILL, J.P.
Mr. J. E. GREENWOOD
Mr. GEORGE HENYORTH

Mr. J. R. HOOKS, F.B.A.
Mr. N. KALDOR
Mr. W. J. KESWICK
Mr. J. MILLARD TUCKER, K.C.
Mr. E. R. BROOKES (Secretary)
Mr. D. G. DAYMEND (Assistant Secretary)

Mr. F. BOWEN, C.B.E., Mr. F. M. GILLIAT and Mr. W. J. LUTKIN, on behalf of the Association of British Chambers of Commerce: called and examined.

MEMORANDUM SUBMITTED BY THE ASSOCIATION OF BRITISH CHAMBERS OF COMMERCE

EVIDENCE PRESENTED UNDER HEADING A.

GENERAL SOCIAL AND ECONOMIC QUESTIONS

1. Terms of Reference

In presenting the views of its members the Association endeavours to confine its comments within the terms of reference of the Royal Commission. It must, however, formally protest at the limitation placed on the work of the Commission by the inclusion in the terms of reference of the words, "and to make recommendations consistent with maintaining the same total yield of the existing duties in relation to the national income".

It is the weight of taxation of profits and income which is the main evil of the present system. Anomalies which would be tolerable when rates of tax are low become damaging to the economic life of the country when the rates of tax are as high as they are at present. Whilst the incidence of the tax can be improved by adjustments, far greater benefit would accrue from reducing the total tax.

The inference in the terms of reference that—whatever increases of real national income may be achieved by more intense effort—the Treasury will require the same proportionate share, would in itself ensure that the maximum effort would not be made.

2. Report of the Expert Committee on the Definition of Taxable Business Profits

Comment on the recommendations of the Committee provided over by J. Millard Tucker, K.C.,* falls more naturally under the class of questions grouped under Heading B as particular matters, with the major exception of Chapter III of the report headed "Inflation". The proper definition of taxable business profits in a period of persistent decline in the value of the money, which is the medium of exchange for goods and services, is in itself a serious economic problem. The Association regrets the inability of the Committee to understand that artificial profits are not real profits from the business or any other point of view and that it was part of their task to define the relation between artificial profits and real profits. Only when that task has been done is it possible to prevent the erosion of the substance of the capital and to confine taxes on income to the yield on that capital.

Further comment will be submitted later.

3. Guiding Principle

It is desirable to try to define at the outset what should be the theme of representations to the Commission. Strict adherence to the terms of reference involves that reductions of tax in some places should be balanced by increases in other places so as to leave the total yield of taxes on income undiminished.

The most urgent need at the present time is to stimulate a progressive increase in the real national income—that is, to create national wealth in the form of physical equipment and human skill and zeal in the use of it. Taxation cannot assist this process because all taxation is deterrent. But if taxation is inevitable, it should be so devised as to be at least regressive as possible to national production.

The present representations are framed with this objective.

4. General Observations

Before answering the questions suggested by the Commission under the separate headings of remuneration, business profits and dividends, some general comments are submitted on the relation of income taxes to productive effort and to inflation, and on the difference between taxes on income and other taxes.

5. Capacity to pay

The power to produce income is not necessarily the same thing as the capacity to pay income taxes which is the principle round which the present system has been built. Capacity to pay has been understood to mean the mere possession of an income above the exemption limit, the capacity being deemed to be greater as the income increases in amount. This ignores the effort and risk which are required to produce income. In practice, the phrase "capacity to pay" tends to be a mask for the simple process of getting money from wherever it can be found without regard to the consequences of depriving the owner of it. If the promotion of an increase in production is the first requirement, these consequences have to be considered.

It is popular and satisfying to tax the rich and exempt the poor. But in fact it is not so simple as that, because the same process involves placing burdens on the energetic and creative citizens and absolving the unproductive citizens, whether their lack of income is due to misfortune or to laziness. It is not easy to distinguish in a taxing system between passive wealth and creativeness at the top of the scale, and between involuntary poverty

* The Committee on the Taxation of Trading Profits. Cmd. 1128.

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[Continued]

and improvidence at the bottom of the scale. To stimulate an increase in the national income, creativeness should be more lightly taxed than passive wealth.

6. Willingness to earn income

All income requires effort to produce it, except that of the rentier and his income represents a claim on the effort of others by reason of past efforts of the rentier or his ancestors. There is a point at which the producer of income ceases to produce. That point may be determined by the limit of physical or mechanical resources, however willing the producer may be. It may also be determined by the willingness of the producer to continue his effort. Most people, except the improvident, will work to cover their needs. The extent of their needs depends on their responsibilities and on the assistance they get without working. Beyond that point they are working for extra amenities and a higher standard of living for themselves and their dependents, or for savings to provide for life when they are no longer able to work. In this field the point at which they cease work is in their discretion, and the choice lies between the incentive of the benefit to be derived from working and the attraction of doing other things. The further the worker has passed the point where his needs are covered, the weaker is the desire to work. Also in some cases the difficulties of earning income increase with the increase of the income. The last pound of profit is hardest to earn.

Taxes on income can, therefore, work both as an incentive and as a disincentive to further effort. If the needs of the worker are greater than the exemption limit and he has to pay some tax before his needs are satisfied, the tax is added to his needs and he must work more. Past the point where his needs plus tax on them are covered, tax is a disincentive, because in the discretionary field it reduces the benefit to be derived from working and lowers the point at which the reward ceases to be worth the effort.

7. Income tax is not wholly a "direct" tax

A tax on income has been termed a "direct" tax because it is deemed to be borne by the person on whom it is charged and is not passed on to others. The theory is that in circumstances of free competition, the marginal producer who earned no profit, and therefore paid no tax, could under-cut the producer who earned a profit and had to pay the tax. Therefore the tax came out of the superior efficiency which enabled the profit-earner to produce more cheaply and the tax rested with him.

In actual experience, however, it has not worked out that way, otherwise traders could not have stood the increases in the rate of tax from 5 per cent. to more than 50 per cent. of the profit. The competitive circumstances very rarely exist which the theory pre-supposes. It has been the common experience that in a time when demand is greater than supply, the supplier, whether of goods or of labour, has been able to increase his price in an effort to retain nearly the same net reward after tax as he had before the tax was levied or increased. By this means some of the tax has been included in the price of goods and services to the public and it has been the consumer who has borne the tax. Except to the extent to which tax is used to meet expenditure which otherwise would fall on industry, income tax tends to be inflationary. Income tax has had the effect of forcing up the price of goods more than they would have been had there been no income tax.

It is a long time since supply was greater than demand and it is still to be seen whether the change in the organisation of business and labour will permit prices to fall to the extent that shortages have advanced them. It is more likely that a contraction of production will reduce the surpluses, whether they be of goods or of labour, and prices will not be allowed to fall naturally. It is possible that a slackening in activity in the private sector will be counteracted by increased Government expenditure to avoid unemployment. If surpluses do arise, profits will tend to fall and with them the yield of the tax on profits. Taxes on turnover and death duties will then be relatively more important sources of revenue.

8. Economic effect of income taxes and other forms of tax

By and large, all taxes work in the same direction. The total production of the community goes into personal consumption or capital expenditure (or into overseas invest-

ment or disinvestment, which is only a sub-division of capital expenditure). When the State appropriates 40 per cent. of the production it spends the resources similarly on personal consumption (e.g. salaries, pensions, and subsidies), or on capital expenditure. If, in addition to that which the State spends on their behalf, the citizens still wish to spend the same amount on personal consumption and on private capital expenditure, the value of money falls and private expenditure is automatically cut by rising prices. If the citizens accept the burden of taxes by reducing the amount of money they want for themselves, the State can take the sacrifice without creating an inflationary situation. (It would be out of order to discuss here the other alternative of reducing government expenditure.)

The differences between the three groups of taxes, namely, taxes on turnover, taxes on income, and taxes on capital, lie (a) in their effect on the balance of supply and demand, and (b) (which is nearly the same), their acceptability to the public.

Taxes on turnover have an immediate effect in increasing the cost of goods and so reducing consumption. Because they are obvious and they affect everybody, they are unpopular. Conversely, reductions of them tend to reduce the price of goods. They have a stronger psychological effect.

Taxes on income are slower in their effect, especially if they are based on the income of a previous period. They are ultimately passed on to the consumer by the supplier but after a time lag. If the consumer is not also an income producer he has to bear the tax and it diminishes his consumption, or savings, or capital. The yield of taxes on income shrinks more rapidly than that of turnover taxes in a recession.

Taxes on capital are longer deferred in exercising their effects because they cut into the resources available for capital expenditure and so prevent a cheapening of the costs of production or even prevent the rate of production being maintained. At a time when saving is greater than capital expenditure, e.g. in a depression, it may be desirable for the State to increase its capital expenditure out of taxes but certainly not on capital. But depressions which are caused by shortages of raw materials cannot be cured by fiscal measures. Taxes on capital are generally inefficient instruments of fiscal policy.

If one were considering incentives alone, it is better to tax consumption rather than the creation of income but it is not practical to follow this too far.

IS THE PRESENT SYSTEM OF TAXATION SATISFACTORY, OR COULD IT BE IMPROVED?

9. Salaries and Wages

It is proposed to deal firstly with the taxation system in relation to the taxation of salaries and wages, including P.A.Y.E.

10. Incentives

(a) Remuneration from practically all employments in the United Kingdom are subject to deduction at source under P.A.Y.E. There is no doubt that some method of deduction at source must continue while tax is so high, because employees could not pay the tax in any other way.

The deterrent effect of P.A.Y.E. is different with different types of employments and with the standard of labour relations in particular trades, apart from tax. P.A.Y.E. can be an excuse rather than a cause for refusing work, in some instances. Nevertheless it is the view of many employers that P.A.Y.E. is a serious deterrent in its present form.

The machinery of P.A.Y.E. can be improved. Now, the heaviest tax falls on the last pound earned by extra time or by piece work. Cessation of earning, whether voluntary or involuntary, leads to a refund of tax. This unnecessarily exaggerates the repressive effect of a tax on earnings of manual wage earners.

Since P.A.Y.E. is one of the particular headings under B, discussion of mechanism will come up later.

(ii) The jumps in the rates of tax are too large, from nil to 2s. 4½d. on the first 562 10s. of earnings, to 4s. 4½d. on the next £250, and to 7s. 7½d. on the balance after

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[Continued]

19. *Redistribution of income (and wealth)*

It is necessary to protect the substance of business from disipation under political objectives which aim at reducing inequalities of income and of wealth. Without discussing whether those objectives are socially desirable or not, it is self-evident that some private individuals must own all the capital and ultimately receive the income of businesses which are not owned by the State. The groupings of capital which are necessary for the maintenance and conduct of business must be preserved intact for the sake of the business, however much the individuals may interchange who own the capital. In fact the ownership is continually changing hands by sale under the normal influence of saving or dissaving by the individuals concerned, or by inheritance on their death. But this change of ownership usually has little effect on the concentration of capital which represents the business unit because the owners or their agents, the managers, are careful not to make such distributions of profit which might prejudice the productive capacity of the business.

If however the State should decide that the owners of the business have too much income in relation to their fellow citizens, or too much wealth, and that it is socially desirable to take away some of that income, or wealth, by means of taxation and to give the benefit of it to other citizens, little regard is paid to preserving the productive capacity of the business. The taxation is laid on the business as a means of appropriating part of the income, or the wealth, of the owners of it. This procedure can injure the productive capacity of the business by extracting more money than it can afford to spare, having regard to its commitments and potential developments, although the imposition may be in accordance with the scale of progression which may have been accepted by the legislator as being desirable from a social point of view.

It is necessary to preserve the business unit, which is a component part of the entire national productive and distributive mechanism, from tax claims which are aimed at the owners in their capacity as individuals.

At the moment, the separation of the business unit from the individuality of the owner is determined by the legal form in which the business is organised. If the business has adopted corporate form, the business is insulated from the personal income tax claims on the owners of the shares, if one reserves for the moment the question whether the standard rate of tax is too high or too low, and reserves the question of levying surtax on certain closely held director-controlled companies.

If the business has not adopted a corporate legal form, it is entirely unprotected from the financial effect of the personal tax claims on its owners. A business owned by a partnership is taxed as though it were a group of separate individuals and the tax claims on it are a simple addition of the tax liabilities of the individuals calculated by reference to their total income. The grouping is merely a convenience for collection because the partners are jointly (and severally) liable if one ignores for the moment the possible difference between the shares of the partners in the income of the basic year and the shares of the partners for the year of assessment.

More simply still, the sole trader is completely identified with the business and the tax claims on the business are the tax claims on him as an individual.

Where the profits (or the shares of profit in the case of a partnership) are small, the tax claims are less than they would be if the business had a legal corporate form. Where they are larger and surtax arises, they can be greater; that is, if the Profits Tax is ignored or if the surtax liability exceeds the Profits Tax liability. It is recommended elsewhere in the evidence that the Profits Tax should be abolished by merging it with the Income Tax so as to have one tax only on profits, and it will be convenient to discuss the immutability of the business from high personal tax claims on the owners solely in terms of the Income Tax and Surtax.

It can be urged as a solution to this question that all businesses can achieve immunity from personal tax claims on the owners by adopting a corporate form. For small businesses this is unnecessary and impracticable, involving as it does compliance with the Companies Act and possibly higher tax claims. For certain trades and professions it is necessary to preserve the unlimited

liability of the partners or it may be necessary to preserve the personal qualifications and professional responsibilities of the individuals. There is nothing to be gained by forcing a corporate form on the business merely to overcome a tax problem if there is any other suitable method of meeting the tax difficulty.

In essence the tax problem for partnerships (and sole traders) beyond a given size, lies in the inclusion in the total taxable income of the partners of moneys which are employed in the business and which are not available for distribution to the partners as earnings or drawings. From the economic objective of preserving the productive capacity of the business, the business should be relieved of tax claims on such retained profits beyond the flat standard rate of tax.

From an administrative point of view it is impossible to adopt a criterion of taxation which depends on whether profits are retained in the business or withdrawn from the business unless two conditions are satisfied. The first is that the accounting adopted by the business should be good and should show how the capital is employed and provide a clear link between the profit and loss account and the movements in the assets and liabilities in the balance sheet during the year. The second is that the accounting should show that the capital is employed in the business (that is, it excludes private investments not connected with the business) and that the retention of the profits in the business is required or desirable for business purposes and not for other reasons.

In the case of public companies these conditions are satisfied because there is not the close identity of interest between the management, which determines distributions of profit primarily by reference to the needs of the business, and the shareholders who are not conducting the business.

In the case of closely held director-controlled companies, the management and the ownership are practically identical. The accounting in these cases will be good because it complies with the Companies Act, but the retention of profits from distribution may possibly exceed the requirements of the business. It is not unreasonable that the mere fact of the possession of corporate form should not result in escaping a tax which would become due if the profits were distributed, when it is clear that there is no adequate business reason for their retention in the company. But it does follow logically that the tax which would become due on distribution should only apply to the part of the profits which is unreasonably retained and not to the entire profits of the year.

Partnerships and sole traders should be given an option to be treated on the same basis as corporate bodies provided that they comply with the standards of accounting which can enable the method to be worked satisfactorily. The option should be irrevocable for a sole trader and for a partnership so long as the members of the partnership are the same. The regulations for the accounting requirements can be worked out in detail after the broad principle is adopted that the profits which are retained in the business for business reasons are regarded as being impersonal and are taxed at the standard rate which is fixed for impersonal income and that only profits which are actually distributed or withdrawn or which are unreasonably retained from distribution should be included in the total income of the owners for the purpose of applying the progressive scale of personal tax. The personal tax claims should be charged on the individuals and not charged on the business, because in the case of distributions, the owners have the money with which to pay the tax and in the case of moneys unreasonably retained, the owners can acquire the money by making a distribution.

20. To resume comment under the headings suggested by the Commission, the following observations are submitted in relation to profits of businesses and self-employment.

21. *Incentives*

The main disincentive is the large proportion of net profit taken by the State if the business succeeds, while the entrepreneur stands to lose his capital if it fails. This is inevitable in the weight of the tax.

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[Continued]

The inception of new businesses could be encouraged by permitting formation expenses to be written off for tax purposes.

The one-sided nature of the risk can be eased by permitting refunds of tax paid in prior years when losses are incurred.

Temporary exemption for the initial years of a new business is not recommended, beyond the personal allowances now available, because difficulties can arise in defining a "new" business.

22. Risk-bearing

The Profits Tax is a special tax on the owners of the equity of a company. The equity owners who bear practically all the risk are taxed in respect of distributions to holders of prior charges in the form of fixed interest stocks.

There should be one tax only on income and profits. This is further developed under the heading of corporate taxation below.

23. Savings

Adequate depreciation provisions are not regarded as savings but as recognition of real losses. Provided taxable profits are confined to real profits the earnings of business could bear a flat rate tax as a provisional payment on account of the ultimate liability of the proprietors. Business can look to its reserves of retained profits for a partial source of finance for expansion after such profits have borne the provisional flat rate tax which is decided to be appropriate to such reinvested profits.

Private director-controlled companies and partnerships should be given the same treatment as public companies, within the conditions suggested above under the general note.

This idea rules out the Profits Tax which in its effects is a direct tax on corporate savings. It also precludes the levy of surtax on the retained profits of private companies and partnerships.

24. Control of inflationary or deflationary tendencies

The raising or lowering of the rate of tax on business profits—which is assumed to be the standard rate tax—is not an efficient instrument for controlling inflationary or deflationary tendencies because it is too slow in operation.

The re-definition of taxable business profits so as to allow reserves for replacement costs of fixed and net current assets, is more effective as a brake on extreme movements of prices. In times of inflation it prevents consumers from getting goods and services at less than their economic cost, and in times of depression it enables the price of goods and services to be lowered more than they could be if suppliers had no reserves set aside for this purpose.

25. The balance of payments including the import and export of capital for investment

The balance of payments on current account is more affected by the development of productivity in general, in which the tax system is only one formative influence, than by special tax measures directed specially to that end.

Foreign capital will not come into the country if the tax rates are too high to permit a net return, after taxes, on the investment, which is greater than could be earned in the home country of the foreigner. Treaties for the avoidance of double taxation can exempt certain types of business profits on a reciprocal basis such as shipping, aircraft, and agency trading.

United Kingdom capital similarly will not go abroad unless it can earn a net yield after tax which is better than can be earned at home. British financed foreign businesses which are technically residents in the United Kingdom will try to emigrate if they are subject to more onerous home taxes by remaining in the United Kingdom.

If the general rule of taxing residents on their income from all sources at home or abroad is retained, it is necessary to liberalise the mechanism of foreign tax credits. These are restricted or withheld on technical points to a degree which spoils the salutary influence of the principle.

26. Effect on the distribution of personal incomes

It is suggested above that the profits of business should be regarded as being impersonal so long as they are retained in the business. The progressive scale of taxation which aims at re-distributing personal incomes should not come into play until the profits leave the business and are at the disposal of the proprietors.

27. Other economic and social questions

No comments.

28. Dividends and Other Income

We have the following comments to make, under the headings suggested by the Commission, on the taxation of dividends and other income.

29. Incentive

No relevant comments suggest themselves.

30. Risk-bearing

In principle capital which is exposed to a higher degree of risk should be better rewarded than passive capital which is lent or invested for a fixed return with some degree of security. This is normally provided by the market. Provided the problem of replacement costs is resolved so as to preserve productive capacity, there does not appear to be a strong case for a lighter tax on venture capital and a heavier tax on passive capital. If tax takes an equal proportion of each, the net yield after tax is still higher for venture capital than for passive capital. This assumes that the Profits Tax, which works completely in the opposite direction and taxes only venture capital, is cancelled by merging it in the Income Tax.

31. Savings

The effect of the progressive scale of tax on total income is to reduce the amount of savings of individuals which can be available for re-investment. This prejudice is inseparable from the rate of tax and must be accepted within the terms of reference.

There is, however, a serious need for collecting small savings which are available owing to the redistribution of incomes. Otherwise the aggregate of private savings is likely to fall below the sum needed for capital expenditure because the persons who used to provide the bulk of the savings cannot do so to the same extent as before the increase in the rates of tax.

Tax-exempt securities of the type of National Savings Certificates should be encouraged, with a limit per individual. A similar effect is achieved by the tax arrangement for Building Society interest and dividends. Tax relief for premiums on life assurance and annuity policies is also an incentive to the collection of small savings. Small savings are, however, not appropriate for supplying risk capital.

32. Control of inflationary or deflationary tendencies

There is little that adjustment of the rates of tax can do in respect of dividends and interest in the way of controlling booms and depressions. This type of income lags too long behind the trade cycle to enable any action on it to have any effect on the cycle.

33. Balance of payments

The improvement of the arrangements for relief of double taxation would encourage international investment of business capital.

A shortage of home savings can be partly compensated by issuing more Government stock, the interest of which is tax free to residents abroad.

34. Distribution of personal incomes

For good or ill, the progressive rate of tax has its full effect on this type of income. There is no power in the recipients to shed part of the tax by getting greater gross incomes as there is in the case of incomes from employments or from business.

35. Other social and economic objectives

No comments.

WOULD IT BE ADVANTAGEOUS TO LINK INCOME TAX WITH SOCIAL SECURITY PAYMENTS AND CONTRIBUTIONS?

35. It is assumed that the question suggested for consideration of witnesses refers to the scheme associated with the name of Lady Rhys Williams and supported by the Liberal Party. Variations of the scheme have been suggested by other writers.

37. Broadly speaking, the scheme envisages:—

(a) A flat rate of tax on all earnings up to £1,000 a year or some such limit. (The weekly contribution to the National Insurance for unemployment, sickness, old age pensions, etc. would be dropped).

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(3) The employer would pay in cash weekly (or monthly) allowances which would vary with the domestic circumstances of the employee.

(4) When not employed, whether due to sickness or lack of work, the employee would draw benefits in cash from the Post Office.

(5) The value of the cash income tax allowances paid by the employer should be approximately the same as the National Insurance benefits. The children's allowance (now payable to the mother) would be similarly paid by the employer when the employee is in work and by the Post Office when he is out of work.

38. The scheme is unsatisfactory for the following reasons, but the rejection of it involves the discovery of an alternative method of removing the deterrent effect of P.A.Y.E. (This will be dealt with later.)

Principle

39. From the point of incentive there is a great difference between reducing a tax demand—which only operates if income is produced—and paying out allowances for no consideration. It would be possible for a man to live on his cash personal allowances and family allowances and a small wage—which would bear small tax. He could deliberately draw more out of the State than he contributed to it.

40. The sick and unemployment allowances are only payable if a man has made the necessary contributions. When these are exhausted he must rely on National Assistance which involves a means test.

Unemployment pay can be withheld in the event of refusal to work without good cause.

To give a right to a payment, regardless of contributions, regardless of work done or unwillingness to work, and without proof of need, is a very dangerous liability for the active citizens to undertake because it is so open to abuse.

41. The National Insurance Scheme was designed to be self-supporting on actuarial bases on calculated contributions by employers and employed, with a limited contribution out of general taxation. It is important that this principle should be preserved.

There is a strong case for extending this principle to other social benefits, e.g. Health Services, Housing Schemes. The only way to check expanding costs of social services under political temptation is to bring home to the ordinary citizen the fact that benefits have to be paid for. If the beneficiaries themselves realised that they pay for the social benefits, the ordinary motives of personal economy would restrain the expenditure of public money.

42. To destroy the contribution basis for sickness and unemployment benefits and to link Income Tax allowances with sick and unemployment benefits would result in placing the entire cost of those benefits on the income tax. The contributions yield about 2431 millions. The future cost is expected to increase considerably. The flat rate on wages assesses the cash personal allowances is supposed to be the same as the present progressive tax reduced by personal allowances. The cancellation of the sick and unemployment contributions would necessitate the Income Tax rate being increased to make up for the loss of them.

43. While Income Tax is a personal tax it does not figure directly in negotiations on wages. The negotiators must fix a rate for the job by the time spent or the piece produced. They cannot consider, in fixing wages, whether a man is paying tax as a single or as a married man with dependents.

If the income tax is made a flat percentage for all regardless of personal circumstances, income tax can be brought into account. Wages can be increased all round so as to make the employer pay all or part of the tax. There would be a strong inducement to inflationary wage increases in a time of full employment.

Mechanism

44. If the principle is preserved that the State cannot pay out as cash allowances any greater sum than it has received as tax from each individual, the work of assessing this check before the cash allowances are paid would be very heavy.

If that principle is abandoned, the cash allowances would become simply a gift from the State, which is objectionable on economic grounds as mentioned above under (40).

45. It is undesirable to separate the income tax on wages under the limit (£200 or £250 or £1,000) from the general progressive scale of taxation on income.

It is not clear how marginal taxpayers, just over the limit, would be dealt with.

It is not clear what cash allowances would be paid out and what reductions, if any, would be made from the flat rate for allowances not paid in cash.

46. It is undesirable to separate the income tax on wages from the tax on other income. If, on the contrary, the scheme covers also self-employed persons and persons with investment incomes, how can it work? These incomes must be dealt with by assessment and by repayment claims in accordance with the progressive scale. There can be no deduction from income if there is no employer to make the deduction.

Persons with mixed incomes consisting of wages and income from real and personal property cannot be dealt with finally by deduction of a flat rate tax from wages and by paying cash allowances. They would have to be re-assessed to fix their final tax in accordance with their total income and the progressive scale.

IS THE PRESENT TREATMENT OF COMPANIES FOR TAXATION PURPOSES SATISFACTORY OR SHOULD IT BE ALTERED?

47. The development of the Profits Tax into an additional corporation tax is bad and should be undone. The Profits Tax, like all other taxes, must either be paid out of corporate savings or passed on to customers in the price of goods, or partly both. If it is paid out of corporate savings, it reduces this source of finance for development. Companies which have not access to the money market (and they are the very large number of smaller and growing companies) are dependent on self-financing for their development. Companies which can invite subscriptions from the public find that the amount of money awaiting investment is risk-bearing ordinary shares is limited and the issue costs are heavy.

Self-financing is the best kind of investment from the national aspect because it is discriminating and the money is the most economically used. It is bad for the State to expropriate these savings by means of the Profits Tax because the State cannot invest them as profitably as the business can.

Some hold the belief that a corporate tax like Profits Tax is more easily passed on to consumers in whole or in part by increasing prices. This however cannot be proved by observation. The main vice of the Profits Tax is that it is borne by the equity holders in a company who also bear the business risks before their price changes.

48. There should be one universal tax on incomes and profits and not two, one levied on corporate profits alone and another levied on all income including corporate profits.

The universal tax on incomes and profits should finally rest on the individuals entitled to dispose of the income and there be taxed at the rates appropriate to their total income.

49. A company should be regarded as an association of individuals acting in common. While the income earned by the company is in the possession of the company, it should be regarded as being impersonal and be taxed at a flat rate. When the income comes into the possession of the individual members, it should then be re-assessed in accordance with their total income.

The machinery at present in force for crediting the shareholder with the standard rate of tax in force when the dividend is declared, regardless of the rate of tax actually paid on those profits, is broadly satisfactory.

50. The desirability of a consolidated return for a parent company and its subsidiaries (down to 75 per cent. holding of ordinary shares) was mentioned in the evidence to the Committee on the Taxation of Trading Profits. The alternative suggestions contained in Chapter VII of the Report of the Committee are accepted, namely, to permit losses to be offset against profits in a group of United Kingdom companies and to value unused stock at cost to the group or at market price, whichever is lower.

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EXAMINATION OF WITNESSES

1094. Chairman: Mr. Bower, I think you and your colleagues were here yesterday?—Yes, Sir.

1097. As you heard me say yesterday, we always give witnesses an opportunity in the first instance of supplementing their memoranda if they desire to do so; I do not know whether you do?—I would just like to say a word in commencement; first of all, we have come separately from the Federation of British Industries. We were able to arrange, with the Millard Tucker Committee—if I can use that designation—to appear together, and it certainly saved that committee a certain idleness. We could have come together this time, because there is no fundamental difference in view. It was just the physical inability to establish common evidence which the two bodies could adopt, because the preparation of this evidence coincided with the Budget, and the limited taxation knowledge that we had was fully employed on the Budget at the time, and we had not the opportunity of getting together and trying to establish a common evidence.

The second general remark is that in the memorandum which we put to you we followed the headings suggested by the Commission as far as we were able. I know this subject of headings is extremely difficult, and in some content what we have said may appear quite irrelevant or not to the point, and I am sure in those cases you will ignore it, but the headings did serve the useful purpose of drawing our attention to points which we might otherwise have overlooked.

In our memorandum, if I can just pinpoint the three main things we are getting at, our aim was to try to find a theme for alterations in taxation, and we thought that productivity was the main target. We know that taxation does not help productivity, it checks it all along the line, but if one could devise an incidence of tax which is least impeding to productivity, that was the kind of thing at which one should aim. The second principle which we are trying to enunciate is to preserve businesses from tax claims which are aimed at the owners of businesses. We must accept as a social and political fact that the redistribution of income is here and has probably come to stay, but there should be a strong distinction drawn between business units, almost regarded as impersonal ships, and the owners of those units, because if you start to lay the burdens of tax on the businesses you have a great danger of shattering the productive capacity of the country as a whole, in the furthering of social aims, by having a very high progressive rate of tax. Therefore in our evidence we have suggested, in a general way, that while profits are in a business they should be looked upon as impersonal things and subjected to the standard rate of tax, but when you start to go beyond that to the higher stages of the surtax, visit that on the owners of businesses rather than the businesses themselves. That is the second point which we are trying to make in the evidence. That same point arises also on death duties, but that is outside your terms of reference. The business ought not to be made the vehicle for finding taxes which are really aimed at the owners of the businesses.

1098. Although it is outside our terms of reference, are you suggesting that the protection granted to retained reserves should be extended to death duties as well as income tax, or are you merely saying you are not interested in that point?—No, I merely mention it by the way, because in the case of death duties in private companies the tax charges can be laid on the company *and* not on the deceased's estate, which is contrary to the kind of thought we are putting forward, just as in Section 21 of the Finance Act, 1922, the surtax regulations, the charge lies on the company. That is a thing we deprecate.

The third line we are trying to get at is the equal incidence of tax as between business and the rest of the taxpaying community. That raises two fundamental points, namely, the question of taxing inflationary profits, which we deprecate, and the creation of the profits tax which is a selective tax and lies only on the owner of equities in corporate bodies. We think those taxes should be spread over the main body of the taxpaying public, and not concentrated on that special body of taxpayers, bearing in mind, because it is a complicated subject, that that particular body of taxpayers may have a power

to shed the tax, which other people may not have in the same degree. We are not interested in the linking of social security payments with income tax, because on the whole we look upon that as more a political suggestion than a fiscal suggestion, namely, an extension of the welfare state, and on purely fiscal grounds we think there is no argument for it whatever.

1099. You did say something about it in your paper, did you not?—No, we have not said so directly, but we have implied that the principles supporting the linking of the two are directed more to social security than to fiscal measures.

1100. Yes. Is that all you wish to add, for the moment?—Yes.

1101. I am afraid the questions I put to you must necessarily be, to some extent, repetitive of what I put to the Federation of British Industries yesterday, but as you were present I shall not ask the questions at the same length because you will have heard what I said yesterday and will understand the reasons for the questions I put, without my stating them at the same length?—Yes. I should also say, Mr. Chairman, that where you have specifically asked the Federation of British Industries to elaborate certain things in the evidence, I can get that from the record and you need not repeat it.

1102. I am much obliged. The first question, which does not fall within that category, is whether you would welcome the Conservative proposals, whatever they may ultimately turn out to be, for the introduction of excess profits tax to absorb the profits from rearmament, at any rate if revenue derived from that source were to enable some reduction in other forms of taxation of income?—It is a difficult question to answer, Mr. Chairman. I thought it over last night, but it means that one is asked to express an opinion about a project which one has not yet seen.

1103. Quite. Your answer may of course be that you prefer to say you will put in another memorandum when you see the project?—That may be the proper reply to give, but after all the proposal to levy the excess profits tax was coupled with a promise to review the incidence of profits taxation generally, and if the proposal could be said to deal with inflationary profits and with the profits tax, and it were merely a question of substituting excess profits tax, then there would be a good deal to be said for it. The argument against the excess profits tax is that nobody has yet devised a good excess profits tax, in spite of . . .

1104. Two wars—in spite of two wars; six or seven countries have all attempted it, but they have never found satisfaction in it. Everything depends on the standard, and if we look at the American technique, their excess profits tax is not so bad as one would suppose, because they have fairly good standards and they have a ceiling to the excess profits tax beyond which the tax would not go. If you have that ceiling you are not far removed from a profits tax. The ceiling lies there, and whether the ceiling is a profits tax on top of the income tax or an excess profits tax on top of the income tax, the only question which remains is how far you can get below the ceiling, and that depends on the rate of tax. The other argument for the excess profits tax is that by its very nature it is a temporary tax, and everybody expects it to go, whereas profits tax may be with us for all time. If you were trying to shed the burden completely you might vote in favour of the excess profits tax in the hope of seeing its demise. But as regards incidence, I think probably the profits tax is better than the excess profits tax, because of the capricious way in which the standards fall.

1105. I seem to remember that when Mr. Gladstone first reimposed income tax he described that as a temporary measure, but I do not think we have ever got rid of it.—The temporary nature of the excess profits tax has been borne out in almost every country, I think.

1106. I do not think, at any rate until we know what the proposals are, I can usefully pursue that further for the moment. If, as I think is certain to be the case, we have not reported by the time the concrete proposals are available, perhaps you will let us have any particular

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observations your Association has to make?—Thank you. If it becomes part of the Budget proposals, obviously our evidence will be directed to the Chancellor first, because he will have a specific legislative proposal for the statute book, whereas you will be looking at the long term effects and may not report for a considerable time.

1107. The next question is on the capital gains tax, which is another matter we are proposing to consider. I should like to know if you have anything to say about that?—That again is a difficult question. There may be loopholes in the system of taxation which could be covered by letting the taxation go beyond the original cost price of the asset you are selling, but the capital gains tax is a terribly difficult thing to administer, and it is terribly unjust. If an employee of a business were removed, say, from Hull to London, in the ordinary course of his career, and he happened to have a house in Hull which cost him £800 before the war, he comes to London and cannot rent a house anywhere and has to buy one, say, for £3,000, by the same influence of the market he may have sold his house at Hull for £2,500, but capital gains tax would charge him tax on the difference between £800 and £2,500; the poor fellow is no better off, he has only got one house and has lost £500.

1108. Does America levy the tax on transactions of that kind, or is it merely confined to Stock Exchange deals?—All assets which a person has held for a time.

1109. But there is a limit to the time, if they have held them for more than a certain time?—Yes, six months, I think. I think they tax him on everything if he holds it for less than six months; if he holds it for longer than six months the individual has an option either to pay tax at 50 per cent on half the profit or to bring it in at his personal rate. With corporations the same kind of thing applies: if held for less than six months, the ordinary rate of profit, if more than six months it is taxed at 25 per cent. which is only one half of the ordinary corporation tax.

1110. You appreciate that the reason why we are particularly interested in this subject is that it is one of the few kinds of profits and income which are not at present the subject of tax. Having regard to the limitation in our terms of reference, that we have to confine our recommendations, at any rate in so far as they are recommendations for immediate action, to maintaining the yield of tax, naturally we are interested in any possible new sources of revenue, and what I really wanted from you was whether you would regard a capital gains tax as worthwhile if it facilitated other measures of reform, for instance, some of the measures which were put before the Tucker Committee?—It is definitely not worth while, not worth the trouble. The inequities which it would produce would quite fail to justify the small amount of tax which might be collected.

1111. You say a small amount of tax, but it is quite a substantial sum in America, is it not?—Not in relation to their total budget. American figures are always larger than ours, and we must look at them in proportion to the whole. I think it is somewhere in the region of 80 million dollars in a budget of several billions, I should say. There is only one thing I should like to mention on that. One of the representatives of the Labour Party has suggested that the capital gains tax might be limited to transactions on the Stock Exchange. He does not bear in mind that there is a tax on turnover with the Stock Exchange already in the form of the 2 per cent. transfer stamp which the Revenue pick up. There is no such tax in America, it is about a quarter of a thousandth, or something like that, an infinitesimal tax, and if you turn that stamp tax into a profit tax you can call it 20 per cent. on the profit which exists already.

1112. That, I suppose, is providing realde does not take place in the same account, because if it does I assume that no transfer duty would be payable on the first "transfer".—That is true. There is only one field I can see where a so-called capital gains tax might operate with fairness, and that will arise in our discussions in connection with inflation, the question of whether, where property is realised for more than its first cost, one should stop at first cost, as the present Income Tax Act does. That is the only field, I think, where in equity and fairness, taking tax as a whole, one could tax the excess over first cost.

1113. That would apply in the house case as well, would it not?—No, I am talking about business. I would not put it on individuals at all, otherwise you would get into football pools and betting, all kinds of transactions like that. You never know where to stop, dealing in motor-cars, bits of furniture; the thing is quite unworkable.

1114. The next thing I wanted to ask you about was the question of whether it is really right to say that income tax could be passed on to the consumer?—In the presence of the economists I give advice with hesitation, but I should say undoubtedly it is passed on. You will find it in every country.

1115. What about the effect of competition?—It does not exist to the extent the classical argument supposes. That is a blunt statement, but if heavy taxation is laid on business, the traders, without any concerted action whatever, all do the same thing. They have all got a burden laid on their backs, so they have got to pass it on in order to live. I have seen this happening in many, many countries. The first example which struck me about 15 years ago was New Zealand; I knew of a little business down there earning £5,000 a year profit. The New Zealanders were the first to adopt high taxation and social welfare, they put up their tax to somewhere about 12s. in the £, and I said: "I can see this business going to the wall." I watched it with interest over the years, and I found that its £5,000 profit became £10,000, £15,000, £20,000, £30,000, and the business was left with more net income after paying taxes than it was in the early days. Whether that is entirely due to efficiency or whether it is due to making a profit on the tax, I would not say, but you will find the same thing happening all over the place. There is one of the tables in the national income figures, on page 46, I think, is the best table, it is Table No. 34 in National Income and Expenditure of United Kingdom, 1946-1950.*

1116. Yes.—That is a very short account which shows the figures for 1938 up to 1950, and specifies dividends and interest, provision for taxation, and undistributed profits on the debit side, and on the credit side corporate trading profits and other corporate income. If you compare the profits for 1938 with 1950, they jump from £80 million to £2,200 million, that is almost 24 times. If you look at the debit side, you will find that dividend and interest have gone up from £570 million to £920 million, roughly it has gone up 60 per cent. You will find that provision for taxation and additions to tax reserves, taking the two together, have gone up from £97 million—call it £100—to £777 million, they have gone up eight times. The undistributed profits—you have got to take these two lines together, add the 60 to the 232, not take it away—the undistributed profits in 1938 were practically £300 million. It is clearer from the 1950 figures where the figure for stock appreciation, of £205 million, is set against the undistributed profits figure of £364 million. That £205 million does not exist, it is really a deduction from the income on the other side, is it not? The point I wanted to make is that the taxation debit has gone up eight times, and I would hesitate to say that taxation debit has gone up because the income has gone up, rather the income has gone up because the taxation debit has gone up.

1117. I am afraid I find that a little hard to follow, because it seemed to me, *prima facie*, that the taxation debit went up because the rate of tax went up.—It is the chicken and the egg.

1118. Maybe. I would have thought the rise of trading profits was due more to the inflation than to the rate of taxation.—I doubt it. I am only trying to suggest that the ordinary business manager has to shed his costs, and if taxation is laid on him to carry he must get rid of it.

1119. That seems to ignore that the taxation is a tax on profits, not a tax on turnover. If he has to pay the purchase tax, that will obviously have to be passed on because that is a tax on turnover, a tax before profits. What I am afraid I have so far not grasped is, unless there is a monopoly, how a tax on profits can *prima facie* be passed on to the consumer. That was the same difficulty I think, which the Colwyn Committee found. Perhaps

* National Income and Expenditure of the United Kingdom 1946 to 1950. Cmd. 8303.

† Report of the Committee on National Debt and Taxation. Cmd. 2800.

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you would explain it a little more?—Perhaps our friends the economists will work out the economic arguments for it, but the fact is that taxation is passed on.

1120. I think I will leave the economists to pursue further this subject, but at present I do not follow it.—Take it this way, Mr. Chairman: business merely has its place in society to provide a service, and consumers have to pay as a minimum price to business a price that will enable business to perpetuate itself and earn sufficient interest on its capital so as to attract and be able to get new capital when it wants. If you put heavy charges on to business, which prevent it from doing that, its self-preservation is thus shod them.

1121. There is one element, one form of tax which may easily be passed on, that is to say, if the tax on salaries and wages is such that on a given wage it does not leave the man with a living wage, he will demand higher wages; of course to that extent, if the trader or manufacturer pays higher wages, he will have to charge higher prices. To that extent I can see that a higher rate of taxation does get passed on, but that of course is not, I think, what you had primarily in mind?—It is the same kind of thing, Mr. Chairman.

1122. That is assuming that the profits left do not represent a reasonable rate of return on the capital invested?—Yes, I can see that that way round, or the economists always say that the increase in price could have been got at any time. In theory it can be got before the tax is increased, but traders do not overcharge or go to the ceiling every time. It is a significant thing that high taxation is simultaneous with a time of shortages, and the situation is such as to enable the price to be passed on. The only thing that stops it is price limitation and government controls on prices.

1123. So you are really saying that if supply were to catch up with demand it might then become impossible to pass it on?—Precisely, but in a period of very high taxation that does not exist.

1124. I dare say the economists will have some more questions to ask you on this subject, but I will pass on. I think you, like the Federation of British Industries, advocate the abolition of profits tax on the ground that it is inequitable, but your only suggestion—at least, your only suggestion, I do not know whether you have any other to make—was that revenue should be found by raising the rate of income tax. That would involve, would it not, about 9d. . . .—One shilling in the £.

1125. I should have thought the psychological effect on the wage earners, and so on, who would have to pay that tax, might be such that it would outweigh the economic advantage to the individual businesses in getting rid of the profits tax?—It opens wider questions, as to how far you are going to carry the income tax down the income chain, but there does not seem to be any ground in equity for putting a selective tax on the holders of ordinary shares, unless you admit my first argument that the tax can be shed.

1126. Suppose the suggestion were that the equity shareholder on the whole has the broadest shoulders, you put the burden on the broadest shoulders?—If you leave him with a free market, yes.

1127. At any rate, you have no new tax that you can suggest?—No. This is where your terms of reference become very embarrassing, as a matter of fact, because one can only talk in terms of taxes on income and profits.

1128. Yes, but I think you have to bear this in mind, that although, of course, any immediate changes which we recommend have to be balanced by some other source of revenue, on the other hand it would not, I think, be outside our competence to say there are other changes which we think are desirable but we do not give them the same priority and we think they must wait till the government in its wisdom can find an opportunity of spending less. What I am suggesting is more urgently sibly there are other changes which are more important than the removal of profits tax in toto.—That may be so, but the thought I wanted to raise is that although it is a question for the Chancellor rather than for the

Commission itself, a progressive tax like the tax on income and profits, which was suitable when taxation was only needed for administration and defence, may be totally overstrained when it has to carry social services of some £1,700 million, and it may be arguable that the income tax is carrying too big a load. It is expending too much, and one should go more into the other kinds of taxes to spread the load on the people who are getting the benefit.

1129. That, of course, is not for this Commission?—I agree.

1130. The next question arose out of your introductory observations, when you said, and I think it also occurs in your memorandum, that you wish to see profits retained in business, by individuals and by partnerships, treated in the same way as reserves of companies and not treated as chargeable to surtax unless they are withdrawn from the business. I suppose you would agree that if such a change were to be made it would become very necessary to provide safeguards against tax avoidance?—Yes, it would need to be policed, I quite agree.

1131. I will not put ideas into people's heads, but there is a certain obvious way in which tax could be avoided, if that were done.—Yes.

1132. The practicability of it therefore depends on being able to devise satisfactory police methods?—That is right.

1133. Passing from my general questions to things arising out of your memorandum, would you look at paragraph 5, where you say: "It is popular and satisfying to tax the rich and exempt the poor", and then you go on to contrast the energetic and creative citizens with the unproductive citizens, but the lines of distinction are not drawn. I suppose in one sense Sir Geoffrey is a creative citizen and I am an uncreative citizen, it could be said that judges create anything. But I should strongly object to a proposal to tax him at a lower rate than me. Apart from that, it is true to say that our present system ignores the effort and risk which are required to produce the income? What about earned income relief?—I do not say it ignores it. The earned income relief does acknowledge it, yes.

1134. Surely earned income relief is just that? It is the method at present in force to give effect to the distinction you make?—Yes. We do suggest that that should be extended. What I am trying to suggest here is that the phrase "capacity to pay" has acquired a certain sanctity over a period of time, as though it should never be criticised. I am trying to say that it is not so axiomatic and true as one usually assumes, there is potential capacity as well as actual capacity.

1135. Dealing with earned income relief, in paragraph 15 you suggest the extension of the earned income relief beyond the present limit: "It could be 10 per cent. of the excess over £2,000 without limit for income tax. The earned income allowance should be extended to surtax". Have you considered what would be the cost of that change?—No, we have not got the figures.

1136. On that, of course, we have got to count the cost. Are you in favour of levelling off the graduation of tax?—You mean, in the lower brackets?

1137. Yes.—Yes, as a halfhearted measure of trying to remove some of the disincentive for the lower income earners.

1138. Short of reducing the general rate, what more wholehearted methods are available than levelling off the graduation?—None.

1139. You cannot see any?—No.

1140. I do not want to repeat my questions, but may I take it you cannot give us any measure of the cost of any of the alterations you suggest? I have asked you about one or two now.—Yes, I have tried to calculate the two things to which we attach most importance, inflation and profits tax.

1141. You have there estimated what it would cost the Revenue?—I have made an estimate, it may be wrong, but I have made an estimate.

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[Continued]

1142. I think that may assist us, if we may have it.—On the profits tax, the yield is about £260 million,* deduct income tax, net it is £136 million. Inflation in stocks, if one can go from the national income figures in Table 33 of the National Income White Paper,† they assume the inflation in stocks in 1950 to be £350 million, if one were to exclude that and take the rate of income tax as 10s., for the sake of ease, that costs £175 million.

1143. Mr. Kaldor: What was the figure you quoted?—£350 million.

1144. Where is that from?—National income figures. You might get it more easily, I think, Mr. Kaldor, from the Economic Survey, 1951‡, page 44, Table 26. The figure there is stated as £270 million.

1145. That is for 1951, is it?—No. 1950.

1146. Chairman: In the Economic Survey of 1951, these are the 1950 figures.

1147. Mr. Kaldor: In the table you refer to it is £265 million?—Yes, but there is another body of taxpayers who are not included in that.

1148. Chairman: In 1951 they forecast £700 million.—That is the point I was coming to, but if that forecast of £700 million is right then the cost would be £350 million, to get rid of stocks inflation alone. On fixed assets, judging by the report of the Commissioners, for 1948-1949, the wear and tear allowances were £390 million; it will be seen from Table 6 of the National Income White Paper that £120 million of that were initial allowances, so you deduct that, you say the ordinary wear and tear allowances would be £270 million. The absence of initial allowances would increase that, call it £300 million, and tax at 10s., so on the fixed assets plane there is £300 million, so if you add those together, assuming the £700 million inflation figure is not right and it is £350 million instead, the cost of that would be £461 million, which at 15 million for 1d. in the £, would be 2s. 6d. on the income tax. On the other hand, if the Economic Survey estimate of stock inflation should be right, one would require another 1s. in the £ for that, so that the cost would be 3s. 6d. in the £ on the income tax.

1149. To deal with those two particular things, do you mean we should require 3s. 6d.?—Inflation and profits tax would cost 3s. 6d. in the £.

1150. That, I suppose, really comes into dealing with replacement costs, if proper provision were allowed for the cost of replacements, that is the same point, is it not?—Yes.

1151. My mind does not digest figures quickly enough to be able to pursue that with you, but possibly by the time I have finished the economists will be ready for you. All I can say at the moment is that the thought of another 1s. 6d. on the income tax is rather terrifying, is it not? Now, in paragraph 21 you suggest that formation expenses should be allowed as a charge against income?—Yes, but that is a trifling point.

1152. Are they not essentially a capital item?—Yes.

1153. And is it right in principle that a deduction in respect of capital should only be allowed for fair wear and tear?—It is the cost of getting money that we are really getting at, but that point we come to under heading "B", in the question of deductions.

1154. Yes, I will not pursue it now, because you put the same claim, I think, before Mr. Tucker's Committee, and they turned it down, so perhaps when we get to the second part of your evidence we shall hear why you say they were wrong?—In that connection, Mr. Chairman, may I ask you for guidance? It is not on any of your heads of subjects, any criticism or approbation or comment on the report of the Millard Tucker Committee. Do you want one?

1155. Chairman: I would put it this way, I think, that prima facie we should be naturally inclined to be guided by that report. If you have any comments, I think it would certainly be desirable that you should include, in what I call shortened form, your reasons for saying they reached the wrong conclusion and possibly have not correctly apprehended your point.

1156. Mr. Millard Tucker: I thought you were doing that, Mr. Bower?—We were, but it is not in the heading.

1157. Chairman: At the time we prepared our formula we had not the advantage of the report. I think it was said that evidence submitted to them would be available to us, but I think after consideration we shall adopt that report unless the report is criticised in some way. If you criticise the report, we should be delighted to hear what you say, otherwise, silence might show that you were converted.

1158. Mr. Millard Tucker: Of course, Mr. Chambers told us yesterday, I do not know whether you were going to join in it too, that he is making a fresh attempt to find reasons why the current year basis should be adopted. Are you doing that also?—We are very half-hearted about this.

1159. Or are you accepting the conclusion that we came to, that it is impracticable?—We have not made up our minds. Logically and theoretically there is no question but that the actual year basis is the best one, and it is mainly administrative trouble. We cannot estimate whether the practical disadvantages are sufficient to outweigh the theoretical advantages.

1160. I do not want to pry, or ask tactless questions, but I suppose your members themselves really cannot agree, can they?—We are not agreed, no. Shall I put it this way: amongst the big questions which this Commission has to deal with, we would certainly give that a second place.

1161. Yes. While you are dealing with that question, I suppose the division of opinion would probably be this: the big companies, with adequate accountancy assistance, would prefer the current year, and the smaller people do not want to be bothered with it?—That is right, until the shoe pinches them, and then they shout.

1162. Would you like to make three returns in respect of every year? I should loathe it myself, I call myself one of the small people, although I would much prefer to be taxed on the current year basis?—We make two returns now. We are asked by the Treasury to give a forecast of what our taxable profits are likely to be, as a matter of guess.

1163. But that is only in the case where previous profits exceeded £10,000?—And then we make our return.

1164. That is only the sort of thing which companies always get every year, so as to help the Chancellor to have some idea of the quantity of profits upon which he can levy a tax, but many of them are notoriously inaccurate, are they not?—I am afraid so.

1165. Chairman: I have very few more questions I want to ask. First of all, will you look at paragraph 10 (i), where you say: "Cessation of earnings, whether voluntary or involuntary, leads to a refund of tax. This unnecessarily exaggerates the repressive effect of a tax on earnings of manual wage earners". The very fact that there are refunds establishes, does it not, that the salary or wage earner has paid more than he ought to have done up to that date?—Yes.

1166. There would be a very legitimate sense of grievance, would there not, if the refund were delayed?—Yes, there would, but is not the fault of this cumulative principle the fact that it is too quick on top of the earnings, because a man might have overtime one week and short time the next week; you would collect a high tax the first week and give him something back in the second week. If his wages were calculated for the fortnight the two things would have washed one another out. I am suggesting that the cumulative principle week by week follows the earnings much too closely and produces this effect.

1167. I do not know whether at a later stage you are putting in definite proposals as to reform of P.A.Y.E., or not?—We are thinking about it, but whether we can reform it, to use that expression, I very much doubt.

1168. Unless you can, of course, it is rather difficult to see how this point which you suggest there, can be dealt with without causing a legitimate sense of grievance. However, I will not press you now. In paragraph 15 you express the view, with which I am inclined to agree, that the existing rule to authorise deductions under Schedule E is unfair. Will you be making suggestions as to what a fair alteration in the law will be?—Yes, I think it will come naturally under the heading of "Deductions".

* Ninety-Third Report of the Commissioners of His Majesty's Inland Revenue. Cmd. 8105.

† National Income and Expenditure of the United Kingdom 1946 to 1950. Cmd. 8203.

‡ Economic Survey for 1951. Cmd. 8195.

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[Continued]

1168. Then I will not press you on that now. I think on the next point also, no doubt, you will be making concrete suggestions at the second stage. In paragraph 16 you deal with the importance of stopping leakage, and raise the question about casual workers. Shall you be putting forward proposals about that also at a later stage?—I do not know how to do it. We know that there is a lot of casualisation; the kind of thing one has in mind is that the workman will cease his legitimate work, to use that expression, at 5 o'clock, and go on to some private work for another person, where Pay as You Earn just is not mentioned at all.

1170. Except by prosecution in the rare cases when the Inland Revenue catch them, is there any means that you are able to suggest?—No, unless you can get the man to make a declaration, but it is a nasty question. A trader might take a lorry into a market, say, at Billingsgate or Southfield, and there are casual fellows standing by; if he wants them to unload the lorry, he bargains about terms, and asks how much, and it might be £1, then he says something about P.A.Y.E., and they put their hands in their pockets and walk away, and the lorry is not unloaded unless the £1 is paid.

1171. The only other question I want to ask you is this: you heard Mr. Tucker cross-examining, if I may use the phrase, Mr. Chambers yesterday on the suggestion that taxation of profits from businesses carried on overseas should be limited to amounts remitted. I do not know whether there is anything you would like to say on that subject?—I thought we got a bit adrift from the subject yesterday, as a matter of fact. We started it by our evidence to the Millard Tucker Committee. First of all we dealt with blocked income, and said it was quite wrong to tax income on which you could not lay your hand. Then, if you admit that, would it not be a good thing to extend the same basis to profits re-invested in the business? The thought lying behind it was that if one has an overseas subsidiary company, that is the basis of taxation, merely a tax on the dividends which come home. It is quite a matter of the circumstances of the case, as to whether there is a branch or whether there is a local subsidiary company. If remittances is the proper basis for taxation of a local subsidiary company, why not extend the same basis to a branch, because, except for their legal form, they are pretty well the same method of trading.

1172. Of course, the point, if I understood him right, which Mr. Tucker was getting at in his cross-examination, was that in either case, whether it be branch or whether it be subsidiary, the profits which are not remitted remain in and are used in the business.—Yes.

1173. If the same thing happens as regards a business conducted in England, the profits retained in the business have to bear their proper proportion of the tax. Would it not be said to be inequitable if more favorable treatment were extended towards carrying on business abroad? That is the point I particularly wondered whether you would like to say anything about.—Yes, the distinction between profits earned in the United Kingdom and profits earned abroad is that the foreign government requires taxes on those profits before the British government does. To take a very exaggerated case, if there were a branch in Germany, it would probably suffer 75 per cent. tax on its profits, and if you say that a gentleman with a branch in Germany ought to pay the same tax as if he were trading in the United Kingdom, taking the United Kingdom rate as being 60 per cent., you ought to subsidise him to the extent of 15 per cent. of his profits, if you want real equality. I am saying you cannot ignore the fact that the profits earned overseas have already been taxed. This goes into the wider field as to what should be the frontier for taxing profits.

1174. *Chairman:* I will not pursue the matter myself, but I wanted to be sure it was not overlooked. I will leave Mr. Tucker to ask you questions on that. That is all I desire to ask, I think Mr. Crick has questions he would like to put to you.

1175. Mr. Crick: Mr. Bower, would it be correct to say that the body for which you and your colleagues speak is more widely representative, both as to type of business and size of business, than the body which was represented

here yesterday?—I should say we are a cross-section of the business community which is more widely varied than is the Federation.

1176. That is what I wanted to know, because otherwise there is not much point in pursuing my questions of fact, some of which I put to Mr. Chambers yesterday. I will put them shortly, because you were here and heard them all. You speak, in your memorandum, of the erosion of real capital, as one of the most urgent tax problems. Would you say that that erosion is now actively taking place?—What kind of real capital have you in mind, the stocks and fixed assets?

1177. I am quoting your phrase, "the erosion of real capital"—I think it is. As you pointed out yesterday, there are two aspects of it: one is, is the physical quantity of fixed assets and stocks going down, and the other, is their physical quantity being maintained but you are having to borrow to hold them. Those were the two questions I think you put yesterday. I should think that the second is more true than the first, but it is a very difficult to say. My friend, Mr. Gilliat, knows the textile trade in Lancashire, and perhaps he can tell you better than I can about merchants' textile stocks; where the warehouses used to be full before the war they are now half empty. On fixed assets, we cannot estimate, because we know that in general terms during the war capital expenditure was devoted mainly to munition projects. A lot of those have been turned over to civilian use. There has been a lot of war damage, which has kept down the physical volume, and there has been a lot of catching up since the war, but the effect of licensing regulations and one thing and another has tended to keep the total down to within the bounds of the national income and also to divert the capital expenditure on to nationalised business and government activities. I do not think business has made up what it lost during the war, but I could not prove it to you.

1178. You would say that the more urgent aspect of the problem up to the moment has been the financial aspect?—Yes.

1179. Could you mention any particular types of business activity on which these effects are most conspicuous?—I cannot produce chapter and verse of particular cases, but, generalising, I would say that the small private business is suffering more than the well known and well established business, because a well known and well established business has access to the market and it can get the public to subscribe for its loans or its ordinary capital after paying the market price. But the small business which is not known to the public has only one source, and that is the Bank, and if the Bank credits tend to be restricted then they must restrict their business.

1180. So that, breaking that down, you would say that the effects are more conspicuous in unincorporated businesses than in companies?—No, not unincorporated, but the distinction is between the companies which are known to the money markets, because they have a quotation, and partnerships and companies which are not known to the money market.

1181. And it is a matter of size as well, I take it; the large undertaking will get on better than the small one?—Yes.

1182. Is there any distinction between manufacturing and trading, would you say?—There is a distinction, but I would not say whether it was more acute in one than the other. I should think that the merchant was in greater difficulty than the manufacturer, but I do not know.

1183. Would you be inclined to say that there was any difference between new and old companies, or is it blocking the establishment of new companies?—Yes, it is much harder to get going, to start a business, than to continue an existing one.

1184. So that to some extent the effect is to solidify the existing structure of business and to prevent new entries?—Make it more stereotyped, yes.

1185. It would obstruct enterprise?—Yes.

1186. Would you say that these effects have been rendered more serious or less serious, or will be rendered more serious, by the removal of initial allowances?—More serious. I do not like initial allowances any more than Mr. Chambers does, I think they are quite illogical, but in so far as they are an interest-free credit they must help when finance is a difficulty.

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[Continued]

1187. In other words, the business will tend to find things more difficult after April 6th next year?—Yes, but I would not exaggerate it. It will be more difficult.

1188. One of your proposals is that profits tax should be abolished. I would like you, if you would, to amplify that view for the sake of the next question, and I want to ask you whether you think there would be any value in certain changes in the incidence of profits tax. I do not want to bother you with a lot of figures, but if you can keep in mind the present differential, 50 per cent. and 10 per cent., now suppose you were to raise the amount of revenue by a flat rate on all company profits, do you suppose that industry would thereby be induced to distribute more dividends or less, or would the effect be neutral?—I do not think it would have much effect. The reason I say that is that business is tight for money, and distributions are governed very largely by a wish to keep open their access to sources of new capital. If they do not declare reasonable rates of dividend they will not get any capital, that is, so far as big public companies are concerned. So far as private companies are concerned whatever they distribute comes under surtax, and they might still be inclined to leave their profits in the business unless they need them to live, leave them as they are now, if the rate became a flat rate. But you must first tell me what rate you are thinking of.

1189. I am assuming the same yield which on my calculation would give a flat rate of about 20 per cent.—I would agree that. I think the effect would be better because it would have this advantage: it would partly offset for the difference in gearing of the capital of companies. Some companies which are highly geared now have a totally disproportionate load on equity shareholders compared with others which have just ordinary shares.

1190. But on balance you would not expect it to have any very powerful effect?—No.

1191. And you would not see any particular gain from the point of view of industry in taking a flat rate as compared with a differential?—I prefer it. There is a point which I would be glad if Mr. Gilliat would deal with and that is the suspension of this non-distribution relief. This contingent liability to pay a 40 per cent. tax.—Mr. Gilliat: This is one of my objections, I think it is a general objection, to the profits tax, that unlike other taxes it has an uncertainty about it due to this contingent liability to distribution charge at some future date, whatever it may be, and with the present rate and the present distinction between the rate of tax on distributed and non-distributed profits it is a very large factor indeed. I do not know whether it is generally realised how far this goes, because if a company distributes only 25 per cent., one-quarter of its profits as dividend, its total burden of taxation at that point, taking only the profits tax which is then assessed and after providing for income tax and the dividend, leaves a balance of profit which is still less than the contingent liability at some stage or other to pay a distribution charge. Of course I know in theory that distribution charge is allowable for income tax, but of course in actual practice there probably will not be any profits available for assessment to income tax at the time when it is paid because it will be when the company is ultimately wound up. In other words, this tax has a great element of uncertainty about it with this differential rate, and that is a thing which I do not think is sufficiently appreciated. It has a growing effect, it is a cumulative thing, and if this tax goes on at the present rates for 20 or 25 years it means in practically every case the profits which were earned and undistributed before profits tax came into operation are going to be subject to this tax at a rate of 40 per cent. I do not think that is generally appreciated, and I do not think it was ever intended that that should be the effect of this tax. There are a great many objections to this tax but that is one of them.

I would like to mention one other objection if I may while we are on this subject, which I think is rather passed over. Years ago, shortly after the first world war, there was a corporation profits tax. The excuse for that was that the build-up of a company enabled the proprietors or the shareholders to get an advantage from the tax point of view which the ordinary business man did not get, but that was before the legislation which came later, about the time that the corporation profits tax was withdrawn, which of course closed the door to the improper

withholding of distributions by private companies which were owned by a small group of persons. We now have the contradiction that on the one side it is still on the statute book, although it is practically a dead letter, that you must not withhold what you can distribute and if you do there is a very severe penalty waiting for you; and here we have another tax which says that you must not pay more than a very small amount otherwise you are going to have nothing left. I dislike the policy intensely and I think it is absolutely wrong and leading us up a very very dangerous road, this stigma that is being attached to the gathering of the fruits of enterprise. I have lived long enough to go back to the time when a man was regarded as a desirable member of the community if he was ambitious and wanted to get on, but we are fast approaching the stage when a man who has those characteristics is going to be looked upon as an undesirable member of the community and if he is going to earn more than the man next door he is going to be under a stigma. I will not pursue that, but it is very closely related to this question of incentive, and of course there are all kinds of incentives. You asked Mr. Bower if there would be any effect on dividends if this distribution penal tax was withdrawn. From my experience, and I think it is probably a general experience, I think it would make no difference at all. I do not think directors look first at the dividend. They look first at the requirements of the business, and I think it is very unlikely that there would be a large increase except in those industries, and there are some of them, where, due to circumstances preceding the war or during the war, the shareholders have had a very poor return for a long time, but that is another question.

1192. Thank you, Mr. Gilliat, for that contribution. Mr. Bower, if you wanted to raise the same profits tax revenue by levying the tax solely on distributed profits then I think you would have to contemplate a rate of something like 80 per cent. Would that be likely to have any effect on distribution?—I think if you are going to make it a direct tax on distribution it would really become a dividend tax.

1193. No, I am computing the profits tax on the amount of distribution.—I am sorry, I thought you were suggesting there might be one.

1194. I wanted to raise the same revenue by computing the tax solely on the amount distributed and I am suggesting the rate would have to be something like 80 per cent. I am asking whether the proportions into which profits are divided, between distribution and ploughing back, would be altered?—Mr. Bower: It probably would be with a rate of that size, you could not help it. The only argument I can see in favour of a tax on distribution as such is that the business has more or less admitted by its decision that it does not require that finance for the purpose of running the business and, since our main theme is keeping the business intact, we would logically have to say as soon as it has gone out of business we are not concerned in it any longer. But a profits tax of 80 per cent. on distributed profits is just too much, I cannot square it with 20 per cent. on all profits. You are assuming distribution is now one-quarter of the profits?

1195. Roughly speaking.—Mr. Gilliat: If it is 20 per cent. it will be an average according to distribution.

1196. No, I am working roughly on £2,000 million gross profit.—If you are correct in saying that the average rate of profits tax at the present time, I do not know how we can tell because we have not had experience of this year's rate, but if it is so that 20 per cent. is the effective rate over all companies today, if that is right, then 25 per cent. only of profits has been distributed. That is the rate it works out at.

1197. I think it is broadly true.—It is exactly 20 per cent. if you distribute one-quarter of your profits.—Mr. Bower: There are the fixed preference dividends which the company cannot avoid, that is not in its discretion at all, and it would compel a revision of the tax to exclude fixed preference dividends and put them in the debenture class.

1198. Broadly speaking, you would say that up to the moment, at any rate within the range of the figures that we have known, the differential rate of tax has very little effect on the distribution of profits as dividends?—Not a great deal, I should think.

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[Continued]

1199. There was one passage in your memorandum, Mr. Bower, that I confess defeated me, the second sub-paragraph of paragraph 24. I wonder if you could make that a little clearer.—Depreciation and stock values. We are assuming that the trader enters into his cost price of his products the proper depreciation at present day rates and the replacement price of his stocks. That means that his prices would have to go up by that amount. In times of inflation the corrective, if a corrective were desired, is to check consumption, and the increase in the price of the products would automatically check consumption to that extent, almost like putting a tax on consumption, and that would tend to be a brake on inflationary tendencies. There is nothing more than that in the thought.

1200. I see that more clearly now.—Trying to make the public pay at economic prices for the products they are using or getting.

1201. But I understood you to say earlier that in your view the taxation of profits at its present level was largely passed on to the consumer and in that respect became itself inflationary?—Yes, it can be so.

1202. But if it can be passed on to the consumer, and this is a different point which rather puzzled me in the previous discussion, why do you object to it so strongly?—Because it is not everybody that can do it.

1203. If you are heavily taxed and you can pass it on to the consumer . . .?—If you follow that doctrine through to its end, why have an income tax at all? The turnover tax would do it far better and we should not be sitting here.

1204. That is one view to take but, broadly speaking, would it be true to say that you feel on the whole that the use of taxation as an instrument of economic policy is not a very happy development?—I heard you put that question to Mr. Chambers yesterday, but you have to define what you mean by "the use of taxation as an economic instrument." The Chancellor of the Exchequer when he is making up his Budget as best he can in the state of the country, has got to consider what taxes he will raise and how he will raise them, and he has got to decide whether the rate of tax shall be 5s. in the £, 10s. in the £, or 15s. in the £, according as he deems proper for those particular circumstances. But what we do deprecate is tampering with the definition of what is profit or what is income. What is profit or what is income is a question of fact, there is no argument about that, and one ought to be certain as to what profit is or what income is. Then the Chancellor can adjust his rates as he sees fit in connection with the economic situation. What one would strongly deprecate, and I think this is where one departs the initial allowances, is that if you want to control investment, income taxation is not the way to control investment, either to encourage or to depress it. If you want to control investment, control it by putting a direct tax on investment itself or subsidising it, but do not do it in a roundabout way so that the effect is that it does not have any effect at all or produces other effects which you never expected. The definition of income is a firm thing which should not be altered and which cannot be or should not be used as an instrument of economic policy, but the rate of tax on those profits is the economic policy instrument which the Chancellor must use.

1205. You would prefer direct tax?—Yes.

1206. Mr. Hicks: Might I first of all ask you something further about your remarks about income tax entering into price? Might I be allowed first of all to say, since the matter was rather thrown at the economists, that I do not think as applied to a situation as we have at present that economists as such have any necessary *pari passu* on this matter. A particular view on this matter has been quoted from the Colwyn Report* of 20 years ago when circumstances were very different. Even at that time there was a good deal of discussion among economists as to whether that conclusion was valid, and I do not think it can be said that the conclusion was universally accepted among even economists of the present epoch. But we are now dealing with the figures and with the information on which Mr. Bower is basing his statements. We are dealing with an inflationary period in

which economists would be at any rate perfectly prepared to admit that things might be different. It is essentially a question of fact. I would like to ask Mr. Bower in the light of that first of all how far price control has to do with the matter? It seems to me that possibly one thing which might happen under conditions of inflation in which prices were fixed by public or semi-public regulation is that the prices which businesses would ask for and press for would be affected by the taxes on profits which are charged, from the point of view of trying to keep the reserves of businesses in proper condition. How far does Mr. Bower base his argument on that kind of thing?—I do not base my argument on that at all. My only answer is where a price is controlled and where tax is not an element of costs obviously you cannot pass on the tax to the public, and what happens there is that that business will gradually go down in relation to other businesses or, if it is not controlled on all its lines but only on some of them, it would make more profit under non-controlled lines in order to make up for the loss on the controlled lines. It is like stepping on a tyre, if you press it in one place it comes out in another.

1207. But surely it is the case that controlled prices are changed and they are changed very often as the result of representations which have been made by the business concerned?—But they would not bring into their calculations any questions of tax. They take their production factors and distribution factors, but they would not regard tax on the residual profit as being a proper cost to bring into the controlled price.

1208. So you would hold that it was the non-price controlled articles to which your argument applied?—Yes. That is one of the serious parts about it because the price control attaches to those industries which are looked upon as being most vital from the social point of view, and these very businesses which are most important to the country, by price control, are being depressed into a weaker position than the others which, *ex hypothesi*, are less essential and can recoup themselves.

1209. Do you think that income tax on shareholders and profits tax on companies acts in much the same way in respect of being passed on?—Income tax on shareholders, no, I do not think they do.

1210. It is the profits tax on companies to which the argument applies?—The profits tax on companies is more easily passed on in price than a tax on shareholders' receipts, put it that way, because it is a business cost whereas the tax on a shareholder's dividend is part of his dividend.

1211. Might I next turn back to this passage in paragraph 24 which Mr. Crick was asking you about, this passage beginning—"The re-definition of taxable business profits . . ." It is surely the case, is it not—I did not quite follow your discussion with Mr. Crick—but it is surely the case that if businesses were encouraged to set their depreciation allowances at a figure which corresponded more closely to the current cost of replacement, that would tend to cause them to put their prices up more in times of inflation and put them down in times of deflation?—Yes.

1212. Consequently, the movement of prices would be greater, would it not?—No, I think not. There are two things acting in contrary directions, are there not? If a trader puts up his price now to cover his depreciation and that is not allowed for tax he must cover the tax as well, so the person who is in a position to do it covers himself for depreciation and for the tax, hence his price goes up still higher. But I cannot quite follow in my own mind whether those things are working at cross-purposes or whether they are working in the same way. There are factors working in two directions, and I cannot quite sort out which is which. When a depression comes and prices do fall, replacement costs fall, the depreciation element is smaller in the price, and the trader can bring his prices down more, which would be the corrective which you are looking for to check the depression.

1213. I think I agree with Mr. Bower on that. I am not at all sure about the effect on prices, but I think I agree that, in so far as the re-definition would cause business savings to increase, it would have an anti-inflationary effect. May I ask one point in relation to your remarks about casual workers. I just wanted to ask whether there was any evidence for holding that the reluctance to work overtime or casual overtime was simply a matter of the initial earnings being charged to

* Report of the Committee on National Debt and Taxation, Cmd. 2802.

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[Continued]

tax at any rate or whether it had anything to do with the marginal rate being higher than the average rate, a point on which we have heard so much?—I do not think the marginal rate being more a factor. The objection is to paying any tax at all, because it is quite obvious you are not dealing with a class of person who thinks a lot, his instinctive objection is to paying any tax at all.

1214. Mr. Kaldor: May I just ask a few more questions on this question of the effect of income tax and profits tax on prices and whether they are passed on or not? You would agree, would you not, that the only way in which a business man can pass on direct taxation which is charged on his profits is by raising his profit margin, that is right, is it?—Yes.

1215. So that, in so far as income tax or profits tax is passed on, profit margins must necessarily increase at a percentage of the selling price?—Yes.

1216. Would you say that since the war owing to this big rise in income tax and the introduction of profits tax, profit margins are now much greater than they were before the war?—What do you mean by profit margin?

1217. I mean by profit margin the profit margin charged as a percentage of the selling price. You just agreed with me that the only way they can pass on income tax and profits tax is by charging a higher margin.—Yes, and so they get into a spin.

1218. I do not know whether they get into a spin, but business men can only pass on the income tax and profits tax levied on their profits by increasing the margin of profit in the selling price, you agree with that?—Do not stop there, you have to go on to the end. The more he increases his margin the more profit he makes, the more tax he pays, and so on to infinity.

1219. But he must increase his profit margin in order to pass on the tax?—I want you to define what you mean by a profit margin. I mean the net margin after tax, that is the only thing that matters to me, not the gross margin of which tax is going to take 75 per cent.

1220. It may be that only the net margin matters to you, but my proposition was, and I asked you to answer yes or no, whether you would agree with me in suggesting that the only way the business man can pass on taxation is by increasing the gross margin, you would agree to that?—Yes.

1221. Would you say that gross margins have increased since the war?—Yes.

1222. Have you any evidence on this?—Take nearly any company's profit and loss account except the price controlled businesses.

1223. You quoted to the Chairman before in support of your contention, Mr. Bower, some figures from the National Income White Paper, Table 33. Would you care to look at Tables 33 and 34 again. You quoted as evidence the fact that income tax and profits tax based on corporate profits have increased so much between 1938 and 1950. You quoted these figures: if you look at corporate trading profits on the right hand side, 2543 millions to roughly £1,800 millions, so that undistributed profits have increased despite a very large increase in taxation. However, when prices are rising costs are rising and wages are rising, you would agree, would you not, that the mere rise in profits is not evidence that the margin of profits has also risen, or would you not agree to that?—I do not know where you are going to.

1224. May I repeat the question that when costs of production are rising the mere fact that the sum of money profits are rising is not sufficient evidence that the profit margin, the relation of profits to the selling price, is also rising.—Would you say that again?

1225. When there is inflation prices are rising, costs of production are rising, wages are rising. . . —Costs are going up, yes.

1226. Now you agreed with me that in order that income tax or profits tax could be passed on to the consumer or to the buyer it is necessary that profit margins should be raised, the gross profit margin, you just agreed to that before. I am putting it to you now that the fact that profits are rising in times of inflation does not mean that profit margins are rising.—I do not know what you mean.

1227. You suggested to the Chairman that profits were rising. . . —Take it the other way round. You say your costs are rising, wages, raw materials and things like that, and I think you are leading up to the fact that I am saying income tax is a cost, therefore that has got to be added on to the cost.

1228. I am not leading up to that at all. I am leading up to the fact that you were suggesting that profits were rising and you put that forward as evidence of the fact that taxation is passed on because net profits have also been rising, that was your evidence.—I said that profits have risen two and a half times and one of the causes why they have risen is the eight times increase in the tax, that is what I said.

1229. But if you look at the figures again in the very same tables you will find the trading profits have not risen so much more than wages and salaries. So if you look upon the national product as being made up of slices of different elements of costs, wages and indirect taxes which are paid, then there are profits and then gross profits and net profits, according to whether you leave in taxation or take out taxation. If you look at these figures, they do not support your contention that the margin of profit has risen in relation to other elements of cost, in particular wages, and if the business man had passed on the increased taxation in the form of higher selling prices that gross profit margin would have had to be higher. That is what I am driving at. If you look at these figures and compare the movement of wages and salaries in one column and corporate trading profits in another column, if you take into account the fact that the movement of profits figures is inflated by stock appreciation, then I put it to you, I worked it out just now, that the proportion of corporate trading profits to the national wage bill is not much higher than it was before the war. Unless it is higher it is impossible that the business men should pass on taxation.

1230. Mr. Hicks: What are your figures?

1231. Mr. Kaldor: My figures are corporate trading profits, item (d), Table 33, in relation to wages and salaries. I am not saying these are very accurate figures, but I would suggest that you would need to produce figures of this character before you could show that increased taxation was in effect passed on in the form of higher prices. The mere fact that profits have risen or that net profits have risen is no indication of this. . .

1232. Mr. Hicks: Cannot you call upon Mr. Kaldor, Sir, to give us his calculations?

1233. Chairman: I do not know whether Mr. Kaldor is making a speech or asking a question.

1234. Mr. Kaldor: I am asking Mr. Bower question, but I find it very difficult to get answers.

1235. Chairman: I think it is the longest question I have ever heard. The witness may know what you are asking him but I do not.

1236. Mr. Kaldor: May I very briefly try to repeat my question. Would you then say, Mr. Bower, that profit margins have risen since the war and that the increased taxation on profits, higher income tax, higher profits tax, was passed on to the consumer?—Yes, not entirely, but higher taxation is a cause for the increase in prices.

1237. Would you say it was passed on in greater part, or would you say only a proportion was passed on, and if so was it a large proportion?—A greater proportion.

1238. You would say a greater proportion was passed on?—Yes.

1239. I put it to you that there is no evidence as to this in any published figures I know of, and if you have any evidence, Mr. Bower, I am quite sure the Commission would be very interested to receive such evidence. May I just pass on to another point? You gave some calculations to the Chairman as to the cost to the Revenue of making various concessions. One of these was, if I understood you right, going over to base stock method of valuation.—Not necessarily base stock but cutting out the inflation.

1240. You mean L.I.F.O. or something else?—Yes.

1241. It all comes to the same thing.—No, it does not all come to the same thing.

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[Continued]

1262. *Chairman:* It was not confined to stock, it was the general principle of replacement cost applied to both stock and other assets, was it not?—Yes, you can express it this way, by calculating profits by charging your current costs against current receipts instead of your past costs against receipts.

1243. *Mr. Kaldor:* But you said, did you not, that there were two factors here. There was the question of changing the principle of valuing current stocks and the other question is depreciation?—Yes.

1244. I am afraid I was not able to follow you. Did you not quote some figures as regards the cost of one and the cost of the other?—Yes, I did. I referred to Table 26 in the Economic Survey for 1951, which gives some estimates of the inflation element in stocks, the figures are . . .

1245. . . £350 million in 1950 and £800 million in 1951, Table 23, page 41 of the Economic Survey.

1246. *Chairman:* The figures were in Table 26 on page 44.—That is the one I was looking at.

1247. *Chairman:* Provision for stock appreciation by companies and public authorities £270 million.

1248. *Mr. Kaldor:* The difference is that this relates to companies only and the other relates to everybody.

1249. *Chairman:* But the figures used were on page 44, were they not?—Yes.

1250. *Mr. Kaldor:* I see, yes. You say that companies would be relieved of taxation on profits of £270 millions in one year and £700 millions on the other, that was your point?—Yes.

1251. Of course you would agree, would you not, that to the extent that that is stock appreciation the gross profit tends to be larger? In other words, in years when prices are rising then with the present method of stock valuation profits would appear to be larger. You would say they are not true profits but at any rate they are additional profits.—Yes.

1252. Hence one cannot simply say that going over to another method of stock valuation brings the revenue so much less because it depends on whether prices are rising or not rising, or whether they are falling.—All I said was if you strike out of trading profits this figure of £270 million the revenue would lose half of that amount in tax, that is all I said.

1253. Yes, in that particular year, but in another year when prices are not rising they would lose nothing?—They would lose nothing.

1254. And when prices are falling they would gain?—In years when prices are falling they would gain by it.

1255. When in a particular year, like 1951, this element of stock appreciation was assumed to be so high, like £700 million here, the total profit would also be correspondingly large.—Nominal profits, yes.

1256. You say that you do not like initial allowances at all, at least that is what I understood you to say earlier?—Yes, I will not say at all, but I do not like them if a better method can be found.

1257. You do not think that if initial allowances are regularly given year by year that gives the same kind of relief to industry?—No, it comes after the event for one thing, and it is no true measure. . . .

1258. After what event?—After the using up of the assets, as Mr. Carrington expressed it yesterday. We think that the depreciation should be provided during the life of the asset, he used the expression the build-up. This initial allowance would not come at any time during the life of the first asset, it would come to you when that asset had died and you have another asset, which exposes another flaw in the argument that if it is not replaced you never get the allowance at all. The other argument is that unless a business's capital expenditure is dead level year by year it is going to have the most extraordinary fluctuations in its tax liabilities from year to year such as would compel the auditors to ask the business to set up reserves to equalise its income. If it were to follow in its accounts what is happening in its tax returns the equalisation reserve would be still more necessary.

1259. I can see that companies for their own accounting purposes must calculate profits for the year and depreciation for the year from different principles; they cannot simply add initial allowances granted in a year as an

addition to the profits of the year, or something of that sort. But your point is that initial allowances give the relief too late?—Yes.

1260. The business ought to get this relief during the build-up so to speak? In that case at any one time you would say it has more cash; would that be a point, that the business would have more cash?—No, it would have more resources, not more cash.

1261. Resources in what sense?—I do not want to quibble, but when you set aside a sum out of profits at the moment it is cash, but you do not leave it lying in the bank, you use it to pay creditors or you get more stock; the last thing you do with it is to leave it in the form of cash, so you say you have more resources.

1262. One of the things you could do with it, and one assumes that normally that is what businesses do with a build-up of resources, is to replace their assets when they are due for replacement.—They use it in whatever way they want to use it, as the business requires. They might put it in fixed assets, or the time may not have come for putting it in fixed assets, they may put it in stocks or use it in any other way.

1263. Would you agree with me for a moment that, supposing the business requires the build-up of a fund merely for the purpose of replacing assets, the money in effect would be lying as cash in the bank until the time comes, as a fund being built up year by year, and when the time comes it is used for the replacement of an asset?—Yes.

1264. *Chairman:* That is not right, he might have an overdraft.

1265. *Mr. Kaldor:* That would reduce his overdraft year by year.

1266. *Chairman:* I think that it is just not true to life.

1267. *Mr. Kaldor:* What I am trying to put to you is if I did have cash there, I am not saying it is true to life, then it would not make any difference whether the relief was given at the time the cash was needed or whether it was given before?—No. In this real world the initial allowance comes at any time between 12 and 23 months after the expenditure. If you want to use that argument you must adopt the current year's basis for taxation. But in point of fact it comes anything from 12 to 23 months later.

1268. Supposing you think of a long period ahead and the business regularly gets an initial allowance, whatever it is, say 40 per cent. or 50 per cent. on any investment it makes; it gets it in respect of the investment of each year. Would you not agree that the resources of the business would be larger, continuously larger?—No.

1269. Would not that amount to the same thing as giving a business an interest-free loan which is not repayable?—Yes, it would.

1270. Which is not repayable?—It is repayable.

1271. Not if the initial allowances are renewed again every year?—Yes, because you get it in the year 1 but in the next number of years, call it 9, you have to pay it back again.

1272. No, you get a new initial allowance?—Then you start all over again. You get a new advance and you have to repay that all over again.

1273. Think of a business which invests regularly every year and gets an initial allowance every year. Would it not be true to say in the case of that business that it amounts to the same thing as getting from the Government an interest-free loan which is never repaid?—It is an interest-free loan compared with writing off the cost of that asset over its life, but it is still different from building up a provision during the life of the first asset. You are going after the fund all the time, and the interest effect of that is very considerable.

1274. May I ask one more question on this? Supposing the depreciation allowances were abolished altogether, the whole system were abolished, and instead businesses were given tax relief for all capital expenditure at a time when it is made; that system would amount to saying that there is an initial allowance of 100 per cent?—That is right, yes.

1275. Would you still say in that case that this would not be as good, and would not protect business against a rise in prices at least as effectively, as your proposal for

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giving depreciation allowances augmented by the increased cost of replacement?—No, because on that line of argument you get no allowance for the first asset.

1276. Which first asset?—The first asset you buy, because you are only going to give an initial allowance on the second one, on the replacement of it; or are you going to start from scratch and whenever a man makes any capital expenditure allow him to write that off at once from now on?

1277. Yes.—That is all right apart from the distorting effect on business.

1278. Why would it have a distorting effect on business?—Because you took the example of a man who regularly re-invests in fixed assets an equal sum every year, they do not exist. The factory is re-built every 40 years or something like that.

1279. Yes, but what is the difference? Take a business which only invests once every 40 years. It gets all its tax at once. Supposing it lays out £1,000 on which under this system it would now pay, for the sake of argument, let us say £300 tax on the year the investment is made, and this £300 tax would be gradually repaid over a course of 40 years in the form of tax-free depreciation allowances, that is the present situation. In what sense can you say business is in any worse position if it gets the whole of this tax repaid in the first year?

1280. Chairman: Are you asking this only in respect of businesses which are owned by companies, or are you asking it about firms and individuals? I want to know because I think the witness might give a different answer. If your questions are intended to apply to businesses owned by individuals and partnerships then it is quite plain that the answer to your question is that it makes a lot of difference because of the surtax, so would you mind making that clear?

1281. Mr. Kaldor: I am sorry, I meant it to apply to companies only.—I have Mr. Kaldor's point quite clearly and really the answer is that if the price level were stable the present system without initial allowances is all one need expect. You are writing off the cost of the asset over its life and theoretically at the end of the life of the asset you have enough money or resources to get another one. What is bothering us is that prices are not level, they are going up and up and up, and the time factor as to when you get the allowance is very important. You are suggesting at the end of the life of an asset you shall have an allowance and say that is adequate compensation for you for what you have lost during the life of the asset while prices have been going up, but I say it is too late.

1282. I was suggesting exactly the opposite. I was suggesting that you have a real complaint when you say that you spend, say £1,000, on an asset at a particular date and when you get the tax back on it in the future it will not be in pounds of equivalent value but it will be in depreciated pounds, in pounds which buy less goods than the pound bought at the time when this expenditure was incurred. I put it to you that surely that complaint can only be made in so far as the expenditure in respect of which the tax is refunded is made at an earlier date than the time of the refund. If it is made simultaneously there can be no complaint whatever. If for the year 1951 you incur an expenditure in respect of which sooner or later you are entitled to tax relief, your complaint can be that when you get the tax relief the money will not be worth as much. But if you get the tax relief simultaneously at the same time as you incur the expenditure, how can you have a complaint on the ground of the value of the money falling?—If you had started this system which you have in mind in 1930, shall we say, and you had allowed us to write off the capital expenditure when incurred, then, before the inflation had ever started, we should not be troubling you at all today, you would be giving us something better than we have at the present time; but the trouble is a long way up the spiral. You are saying—"We will give you an allowance some years ahead for something you are losing now." The timing is all-important in this thing because prices are sliding all the time.

1283. You are saying now, and I agree with you, that business has actually been impoverished by the rising prices which have occurred in the past, and you want some relief in respect of that impoverishment which has

actually occurred. There is another consideration which we had in mind, which is this, the fact that depreciation is on original cost and not on a replacement cost basis. Does that factor retard investment in the sense that it would make a business man refrain from installing equipment because he knows that in the future he can only get back the tax on the depreciated pound as prices are rising, looking forward, and therefore the net return of that investment is less than it would have been if prices had not been rising? When you look at it in a forward looking way, I do put it to you that initial allowances are a remedy to the situation. It is only when you think of it in a backward way that it is not a remedy for the rise in prices that have occurred in the past.—You must excuse me if I cannot follow you in this hypothetical world in which you are living. You ask me whether these things affect the desire or willingness of these business men to invest. In so far as they take money out of the business man's pocket and deplete his resources they must, but that is only one of the factors which influences the business man when he is going to invest. There might be Government controls and licensing which veto it, it is a difficult question. He might have the idea that prices are going to rise and rise and he hopes to get in now and take his chance. His particular trade might be developing in one particular way, either dying or increasing. It is wrong to pick out this particular one and say it is the turning point which will cause him to decide whether he wants to invest or whether he will not invest. It is one element in a complex of motives.

1284. I agree to that, but what we are discussing is whether one system such as initial allowances retards him more or retards him less than an alternative system such as replacement cost allowances.—If you ask me which is the better of the two, to build up the allowance while the asset is being used or give him an initial allowance when he replaces it, I must simply say to give him an allowance while the asset is being used is better than giving him a lump sum allowance when he comes to spend money on the second investment, that is my answer.

1285. Mr. Bullock: I have been studying you all the morning and you have got some technical ability. I am not going to pose questions on technical lines as some of my clever colleagues have been doing, but I am going to ask you one or two simple questions in the hope that I can get an answer. You talked about a man of ambition and you rather generalised—My colleague did.

1286. I am sorry, your colleague, and in a very general way you suggested without any qualifications that the man of ambition was a very good man in the community. Have you in mind the fellow who makes a fortune in whisky and spends it on racehorses, or a fellow who makes it on tea and spends it on yachts, do you call him a good fellow?—Mr. Gilliat: That is certainly not what I meant by the word "ambition". I meant a man who wishes to get on in the world and do something and looks forward to his reward for doing it. In the north where I come from there are many businesses. I have seen them grow myself from small beginnings where a man started perhaps as a workman at a wage of 2s. or less a week. Of course, taxation was almost non-existent then, it could not be done so readily today, but his pure ambition, his desire to get on, carried him on, and that is the sort of thing which throughout the last two hundred years has built up our industry as we know it. If that spirit is killed the whole country is going to suffer for it, and it is a most vital point in this question of incentive. I deprecate the idea that fruits are wrong and should be forbidden.—Mr. Bower: We would not say that the "get rich quickly" man was a good citizen.—Mr. Gilliat: He is an enemy; he tries to extract something without contributing anything. I am talking about the man who contributes something.

1287. All the time you have been talking I have been thinking of our terms of reference and the way we are caged in. Then you said something about a fellow's objection to taxation who did not do any thinking. Is there any real ultimate difference between the thinker and the non-thinker in their attitude to taxation?—Mr. Bower: Yes, I think so.

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1288. Would you say that the man who refused a job at night because he was going to be taxed on it . . . —
 . . . is a non-thinker, because the tax does not take 20s. in the pound.

1289. What about the chap who runs a shop and says, "If there is anything I want that my shop is not selling then I will take it out of the till", he is a thinker, is he not?—I would not call him a thinker.

1290. But the thinker may be a much more dangerous fellow in the community than the fellow who thinks in terms of pennies.—What we have in mind as the thinker is the man who realises that everything the State provides has to be paid for by somebody, and that is the reason for taxation. Therefore he should not shy away from taxation if he realises that he is getting something out of the State for what he is putting in. The non-thinker is the man who takes what he can out of the State without consciously making any contribution to it, I say consciously.

1291. You were speaking earlier on about increased wages being passed on, but you went on to say with the exception of Government controls and fixed prices. You suggested that was the only way to avoid them being passed on?—Yes.

1292. Is that actually your experience?—I do not deal with price controls myself. I only reason that that must be the inevitable end of it.

1293. I have always felt that the people on your side of the table were so much cleverer than civil servants, and when there has had to be an increase in wages they have found ways and means of making a profit on having to give extra wages.—That I do not know.

1294. You have not come across that? You do not know anything about building or civil engineering?—Not with price fixing or wage negotiations.

1295. But you are here to try to shift the burden if you can?—Do not say shift it, adjust it. Shifting means getting rid of it altogether, but adjustment gets round that.

1296. What suggestions have you in mind to obviate inflation and bring about some deflation which would bring back the normality that you have in mind?—That is a question for the Cabinet at the present moment, I think, rather than for me, but I would say that taxation is not the way to control inflation, that there are many other things which are more important and more effective than taxation.

1297. We are in this difficulty, we have to try to swing things round so that everybody is made happier and in the totality they are all paying just as much. Would you not say that one of the prime factors in inflation was increased profits?—No.

1298. I should have thought that was one of the first things that started it.—No.

1299. Are you thinking we ought just to pay back on imports?—No, that is not a tax matter and perhaps I ought not to say it here, but if everybody worked 5 per

cent more than they do both in quality and time the thing is cured, inflation and all our problems, but that is not a tax matter at all.

1300. No. We have had some very wonderful evidence of the ability of the British people to work since the war. It is the war that is the trouble, that is what is being paid for.—We are getting outside tax, are we not.

1301. You have not got in mind the old-fashioned suggestion that we should try to create unemployment in order to get over our difficulty?—No.

1302. Do you not think that that enters into it?—You are leading me on. I say if a man is not getting his weight he ought to be out. To that extent unemployment is justified.

1303. You would be as well aware as I am of the experience from 1921 to 1926, how the thing defeated itself. Do you think full employment is a good thing?—It depends what you mean by full employment.

1304. You cut your overheads and you cut your tax in proportion.—If you want health in the community you want unemployment just under the level of where Lord Beveridge drew his plan, but if you get a definition of unemployment which is less than that you are merely driving it underground and getting concealed unemployment by fellows not pulling their weight. This may be politics.

1305. Chairman: It is a little wide of our terms of reference.

1306. Mr. Bullock: The last thing I was going to ask Mr. Bower was: can he tell me of some equivalent on the F.B.I. side or the Association of British Chambers of Commerce side to do this kind of thing for them—the thing he wants to do so much for the people who are actually producing the work—the effect of unemployment; what can he give as an equivalent on his side?—I do not know what you mean. Do you mean incentive?

1307. Yes.—The open career.

1308. Keep them sitting pretty.—No, not sitting pretty.

1309. Chairman: May I put a question. You said at the beginning of your statement that the main object of your recommendations was to increase productivity. If you achieve that object I should have thought, *prima facie*, that the result must be to improve employment and not to create unemployment?—Yes.

1310. Chairman: I gather the economists do not agree?

1311. Mr. Hicks: We should think it a statement which required a good deal of qualification.

1312. Mr. Bullock: Just one final question. I am not able to get this knowledge and I wondered if you could help me. Have you any knowledge of the comparison in business bankruptcies as between 1935 and 1939 and 1947 and 1951?—I have not got it at hand but the Board of Trade do publish these figures.

1313. Would you not think, in spite of the grumbles about taxation, that they are really better off today than they were then?—I do not think that arises; I do not think so.

Chairman: We will adjourn now until 2 o'clock.

The proceedings were adjourned accordingly

(On Resumption)

Chairman: Sir Harry, I think you have a question or two to put to Mr. Bower?

1314. Sir Harry Gill: Yes. Mr. Bower, I think all the suggestions contained in your document would mean a fairly heavy loss of revenue?—Yes.

1315. In examples this morning you suggested that that loss could be made good by an increase in the income tax.—That is the only way inside the terms of reference.

1316. And two specific items I think were mentioned, and you had made the calculation that that would cost 3s. 6d. in the £7.—Yes.

1317. There are other items in addition to those two so that the overall increase to meet the loss would be something more than 3s. 6d.—The other items are relatively small and would bear no relation in proportion to the two big things that have been mentioned.

There is a sufficient inaccuracy in the 3s. 6d. to cover those.

1318. Then to weigh it all up, you feel that an increase of 3s. 6d. in the income tax would meet the loss of revenue were your suggestions carried out?—Yes.

1319. Would those who are responsible for making these recommendations, if they had the choice, accept that medicine?—I do not know without asking them, but I think it is the logic of it. We are forced into that by the terms of reference.

1320. I agree it is the logic of it, but I have some doubts, if the position was put to those responsible for making the suggestion, that they were faced with an extra 3s. 6d. income tax, whether they would say it was worth while. However, you are not in a position to answer that?—No.

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1321. Mr. Kerwick: I would like to repeat a question I asked yesterday about the erosion of capital due to what is considered inadequate replacement allowances. Would you say that that is a very urgent matter or a trend? In other words is there a danger of industry being in great difficulties immediately?—It depends on the estimate of whether inflation is to continue and whether it is to continue in the same degree as in 1951.

1322. On the assumption that inflation will continue?—It is very urgent, very urgent not only a trend, but if inflation were by some miracle to be abated, then it would cease to be quite so urgent because it is tied up with inflation.

1323. Mr. Carrington: Just one or two very small points or relatively small points. Would you turn to paragraph 11 of your memorandum, Mr. Bower, on risk bearing. In the second paragraph you refer to a rule of tax applicable to earnings calculated by reference to an average of years. Have you in mind there that rate being applicable to all Schedule E cases or only to those where the income is of a fluctuating nature?—The latter. We borrowed this idea from the suggestion made by the Tucker Committee for surtax.

1324. Only fluctuating?—Yes.

1325. It was not quite clear from your memorandum, at least not when I read it. My next point is in paragraph 16 (ii) of your memorandum. Are you suggesting there that the provisions of the 1948 Finance Act in regard to benefits in kind are either inadequate or are not applied with sufficient strength by the Inland Revenue?—Both, Mr. Carrington. They are directed against directors and employees whose earnings are more than £2,000. That is quite arbitrary, there is no reason why they should stop there. The field of persons against whom it is directed is too narrow; they do not apply it to everybody, but on the other hand they are much too strict and go too far in their treatment of tax benefits.

1326. In other words you would spread the field and lessen the pressure?—Softens the rules.

1327. My next point concerns the final sub-paragraph of paragraph 19 of your memorandum, and you may wish to answer me to the effect that you have developed that under Part B. If so, please indicate. Have you considered the position in regard to the retirement or death of a partner in the event of there being some relief given, as you suggest here, on retained profits in partnerships as well as in the case of limited companies?—No, I have not studied what happens on the change of partnership and when the partnership assets have to be re-distributed or paid for. We have not studied that point at all.

1328. Perhaps you would. Actually the late Mr. H. E. Seed and myself gave this problem considerable thought some years ago; that is the great snag we came up against. If you can solve it so much the better. It is a difficult one, I think. And one further point: when you were speaking this morning about the taxation of profits earned abroad, might I suggest that you were a little bit too general in your remarks regarding the basis of taxation of subsidiary companies? You rather led us to infer that whereas all branches are taxed on the profits arising whether realised or not, subsidiary companies are only taxed to the extent of their dividends. Would you like to qualify that?—Yes, certainly. The control and management of the trade must be abroad before that basis can apply. If it is in the United Kingdom then they are treated like branches.

1329. And, of course, the last Parliament saw fit to introduce legislation designed to prevent people—Emigrating.

1330. Or changing the seat of control of their subsidiaries.—[use the word emigrating for that.]

1331. I just wanted you to amplify the earlier reply; I felt it was a little bit too compressed to be accurate.—Yes.

1332. When you come to the heads under Part B, in addition to those mentioned to Mr. Chambers yesterday would you give consideration and illustration of what would happen in regard to stocks in the event of prices falling as compared with the price ruling at the date the taxpayer first elects to go on the base stock method?—Yes. I can tell you now apart from the mechanism

we contemplate that reserves would be set up to measure the extent of the inflation. When prices go down those reserves would be written back to revenue, but we do not contemplate those reserves going below zero.

1333. I do not want to deal with it in the abstract if you do not mind. Would you develop that point and explain it when you deal with your Head B?—Very good.

1334. So that the Commission can follow the implications of drops in prices as well as increases.—Yes.

1335. And consider what effect it would have on the company's balance sheet?—Yes.

1336. Mr. Millard Tucker: Mr. Bower, I see you are in the same position as the Federation, that is to say that although in this particular memorandum you make references to inflation you are proposing to develop that in much more detail later?—Yes, but I can outline the main thought from which we approach this because so many irrelevant factors, if one can use that expression, have been brought into it. We simply look upon this as a definition of how to find out what are business profits. All other taxpayers are taxed on their gross income, but business alone is not taxed on its gross income, otherwise it would be a turnover tax. It is taxed on its balance of profits or gains. The question is to define what is the balance of profits or gains. Where the pound is stable, ordinary conventional accounting brings us out to that result, but when money is declining very seriously in value what you have is really a different kind of currency. The pound of yesterday is a different pound from the pound of today, and the pound of tomorrow will be a different pound from either of those two. If you draw up an income and expenditure account on which the receipts side is in today's pound and all the expenses are in today's pound the result will be pretty well right. If you draw up an income and expenditure account in which the receipts are today's pound and the expenses are partly today's pound and partly yesterday's pound, the result is bound to be wrong. Therefore we have got to look at the income and expenditure account and see which items are expressed in yesterday's pounds, and if we can, to turn them into today's pounds. That would be a correction in order to arrive at the balance of profit which is to be charged to tax. That is the whole gospel and nothing else.

1337. I thought it came down to that. Then what you say is that your profit today expressed in terms of pounds is really wrongly expressed. It is expressed in terms of depreciated pounds?—No, I do not say that, Mr. Tucker. The receipts side is expressed in today's pounds, whether it is right or wrong I am not asking, they are in today's pounds, and if tax were paid in the year in which you earned the profits you would be paying tax in exactly the same pounds; everything would be squared out. That is the last one can do in this human world.

1338. Yes.—But what we are objecting to is having one side of the income account expressed in today's pounds and the other side expressed in yesterday's pounds. It just does not make sense. In order to make it make sense and get all in the same currency one must turn yesterday's pounds into today's pounds then the balance will be as near as one can get it right.

1339. It is upon that basis that you say depreciation ought to be allowed? It ought to be allowed in the terms of the today's pound value of your capital asset?—The amount of your capital asset which has been used up during the year expressed in today's pound.

1340. Yes. Do you give any credit for the increase of the capital value itself?—No, for this reason—that a business has got to turn over its capital or its fixed assets or circulating assets; all have to be turned over so long as the business is a going concern. They could never produce any realizable profits on the side of them. Whatever you sell the assets for you promptly have to reinvest in similar assets and that money is continually locked up. Now there may come a point of time when that increase in value would express itself, and that is on the cessation of the business when it has no longer to be reinvested in similar assets. What happens there is another chapter which we shall probably have to face up to when first we have passed the hurdle of what is the profit of the business as a going concern. The second question, what happens on cessation, brings us into the field of capital gains and there one has got to think what the

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consequences may be. There are already in the legislation provisions for dealing with stock on the liquidation of a business which would have the effect, if applied, of questring out the stocks reserves which may have been built up during the running of the business and make them taxable in the last years of the business. The provisions in the 1945 Act for balancing charges and balancing allowances also may have their effect, but we come up with a jolt to the realisation that the balancing charge is limited to the first cost of the assets, and that is the point that we have to look at. From a technical point of view I would say that is the only thing that need worry us. All the economic considerations that flow from that gospel are consequential and not the kernel of the problem. The kernel of the problem is just the simple one of what is the true way of drawing up an income and expenditure account for the purpose of taxation.

1341. Mr. Bower, without expressing any view whether it is right or wrong, may I say that speaking for myself you have put your case much more logically just now than ever before.—Yes, I agree.

1342. I can understand the case you are putting now that your outgoing during the year in the shape of the using up of an existing capital asset you have already got must be measured in the same kind of pounds as the ones in which your trading receipts of the year are measured. I can understand that. You would have the same problem if it were a matter of foreign exchange?—That is right.

1343. But that is a very different train from that which you put forward before, namely that you want to treat your depreciation allowance as meaning the cost of replacing your assets.—No.—

1344. Based on the cost of replacement.—I am glad you have mentioned that because after all it is two years since we started to grapple with this thing and one's thoughts do develop, not only in the application of how to carry out the principle but even on the principle itself. But right from the very start I have always said that is not a claim for replacement costs or for reserves for replacement at all. The reference to replacement merely comes in in an estimate of what are the current costs to set against current receipts, and that is the only measure or criterion you have. I do not rest anything on the fact of replacement. What I say is there ought to be the resources to enable you to replace if you want, whether you do or not does not matter at all. For instance, if your business requires that you dispose of a fixed asset you might decide not to replace it at all, but put that money in increasing your stocks or in giving further credit to your customers, increasing your debts or paying off some of your creditors. The doctrine of setting current costs against current expenses would enable you to have those resources however you applied them, so whether you replace or not is just an immaterial thing altogether, and any question of identifying one asset with another just does not arise.

1345. That is a different case from the one that has been put up to the moment, is it not? I think we really ought to make a note, a careful note, of it. The present basis of the claim is not to have your depreciation allowance based upon your cost of replacement on today's values, but it is to have your old depreciation allowance translated into modern day pounds.—That is how you would in fact apply it. I would express it this way: I want to put current costs against current receipts. There may be one or more ways of getting at current costs, but to convert your historic depreciation by some co-efficient measured by replacement costs as a general measure of relation into current costs, that is one way of doing it and I would say that would be the claim.

1346. I am glad that you have clarified a little. It has clarified my mind a good deal as to the real nature of the claim. I will put it in figures so that they can go on the note. You can see them afterwards and you are not bound by your answer now; if you want to correct it afterwards you always can. Can we assume that this year the pound is worth only 4s. 8d. as compared with 1939?—Yes.

1347. So that if you get a machine which is being depreciated on a straight line basis of 10 per cent. per annum, but on the written down value, and that machine cost you £100 in 1938.—We had better come up a bit.

1348. We should have written it all off by then; perhaps I ought to say on a 5 per cent. basis, that will make it easier. Your annual charge for depreciation had the pound not depreciated would have been £5 a year.—Yes.

1349. Now you say it ought to be £15?—Yes.

1350. I was not going to ask you any questions about this, Mr. Bower. It did not appear to me this was really a subject on the agenda for today, but I am very glad I have.—I also did not want to go into detail, but I did want at a very early stage to say what is the essence of the claim that we are making because from that comes all the rest flow as consequences.

1351. Mr. Kaldor: You would agree that in your present formulations there is just as much justification for levelling the fixed charges of business as there is for levelling the depreciation allowance?—No, the fixed charges are not expenses in the income and expenditure account.

1352. Why not?—Well, they are not. They are not allowed as expenses.

1353. Mr. Millard Tucker: I myself am not going to put any more questions about that, Mr. Bower, because I want to think out now the implications of what you said and see how far they are valid; whether there is a flaw in the reasoning anywhere and, if so, what it is; so, without accepting it for the moment as being unquestionable, I will leave it there if I may.

1354. Chairman: The result of that would be, would it not, assuming you bought an asset in year 1 for £100 and you replace it in the year 10 you will over that period by applying your principle have got back the full value or the real worth of what you originally spent?—No. There are two elements in it. Assume your machine cost £100 and in the course of 10 years the value rises to £300. Each year as the value rises you would increase the depreciation charge for that year, so assuming you are in the last year the depreciation charge would be £30 instead of £10; but in the year before that we had not provided £30 nor the year before that, but merely a co-efficient of that particular year.

1355. Chairman: You would not get back £300 depreciated pounds but the appropriate amount measured in the currency of that year.

1356. Sir Geoffrey Heyworth: You would have to spend each portion in the year on some other asset; that is what you would do. That is why Mr. Bower introduced that point of bringing in the total resources.

1357. Mr. Millard Tucker: I said I was not going to ask any more questions on that, but I really must ask one more and that concludes what I want to ask. In relation to what year are you going to take the measure of today's pounds, 1939?—No. It is purely a question of when are you going to start this system, because if the legislature were to say, yes, that doctrine is right, we ought to adopt it for the profits for the year 1951, we are logically bound to the year 1951; but there will have been 10 years during which the principle has not been adopted where business has been overtaxed in our theory compared with other taxpayers. Whether the legislature can do anything about that is another question, but that is not a right. That is a request for hardship or concessional treatment. What we claim about current costs against current expenses we claim as a right.

1358. Yes. Would you carry the theory a little further and apply it to cases of ordinary individuals with ordinary incomes, whether trading incomes or other incomes, and say before the war the income left to me after paying all tax was, say £1,000, and it bought £1,000 worth of goods. Today owing to higher rates of taxes I have only £500 left but that will only buy about £180 worth of goods. Therefore I ought to have some relief.—I cannot see any way of dealing with that. You mentioned private individuals?

1359. Yes.—And included in that were businesses. So far as private individuals have businesses, yes, because what I am talking about is business income.

1360. Mr. Millard Tucker: Apply it to my practice for me.

1361. Chairman: Put your fees up.

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1362. *Sir Harry Gill*: It would be simpler, Mr. Chairman, I think, if Mr. Tucker were to put his question about an individual who had a pension and that pension was his sole income. How is he in any different position from the people Mr. Bower mentioned?—So far as we can see there is no remedy for the person who holds war loan or the pensioner except to stop inflation or undo it; there is no other remedy.

1363. Would not your own theory with regard to machinery apply to the individual?—No, it would not, that is why I want to bring this out.

1364. But why? You must understand it puts something very new before us and I am asking why, I am not questioning your answer but I think the Commission, at any rate I personally would like to know why it would not apply to the individual equally as to the machine?—He is taxed on his gross income, the pensioner—

1365. *Chairman*: I think what Sir Harry is putting to you is if it is equitable to make the adjustment in the case of the business man why is it not equally equitable in the case of the pensioner? I think that is your point, Sir Harry, is it not?

1366. *Sir Harry Gill*: Yes.—I am trying to find out what is the true balance on which tax should be levied.

1367. For that purpose you are not considering everything?—I think that is outside our problem, outside the problem of the Commission even.

1368. *Sir Harry Gill*: But you see, Mr. Bower, I purposely took something which was fixed by dealing with a pensioner. An individual had a pension of £200 ten years ago, he still has that £200. How is he in any different position from the machine that cost £200 ten years ago? For the purpose of taxation you want to say that that machine should be dealt with as though it had cost £500. I do not stick definitely to the figure but the principle.—In business that machine has got to be used up and it ceases to exist, and you have to find another one if the business is to go on. All those costs have to go into the profit and loss account. The pensioner has no such account. He just has living expenses. If you wanted to deal with him the only way you could do it is to increase the personal allowances for tax in line with the rising cost of living. Whether you should do it or not is another question, but that is the only way because tax is levied on him on his gross income. With the business you have to ascertain what is the difference between receipts and expenses. The using up of a machine is an expense. I cannot make it any clearer than that.

1369. *Mr. Kaldor*: You are only concerned with profits. If you were not but were concerned with other types of income as well you would say that raising the personal allowances in income tax by some index of the rise in prices is just as justified as raising—.No. I would not say that. I say this: that owing to the inability or refusal to recognise this error in the calculation of profits, business has been overtaxed for the last ten years and we are asking that it should cease to be overtaxed. When the correction has been made then business would be on a square footing with the rest of the taxpayers.

1370. Would you not say that all of us in our personal capacity have been overtaxed during the last ten years because the personal allowances which were, let us say, I cannot remember, £100 a head before the war, and they are very little more now, were intended to provide a certain tax free minimum. They now provide only half or one-third because prices have risen. Have we not all been overtaxed in precisely the same sense?—No, quite different. First you must finish the calculation to arrive at the profit earned by the business. The business may have earned £500 or £5,000 of profit, then you start off from that point and apply your personal allowances. But you have to make the first calculation before you get at your first sum which is taxable. That is not so with your pension or war loan interest; whether you are overtaxed I would not know.

1371. *Chairman*: I think Mr. Tucker had better resume command of the field.—Mr. Tucker asked me to apply this to his own practice. He has no fixed assets except furniture in his office and quite a considerable quantity of debtors—

1372. *Chairman*: I think we shall get to the personal question on the second part of the inquiry; it is rather a red herring for the moment.

1373. *Mr. Millard Tucker*: Now let us go to a different subject. Really I would like a little assistance about this point: that is the disincentive or repressive effect on earning, and effort of earning, of the present system of taxation. If income tax were a flat rate of tax with no gradations at all and provided it was not too big, I suppose it has no repressive effect, has it? On the contrary it might make you work harder?—That is probably right, yes, because you are balancing the natural laziness of not wanting to work with the rewards of doing the work. If you reduce the rewards the inertia gradually overcomes the inducement.

1374. Against that there is always the desire to have some money?—Yes.

1375. It will make you work?—Plus inducement.

1376. Whether you have to pay tax or not?—I do not see much fun in earning money to hand over to someone else. That is where the inertia would overcome it.

1377. But a man has got to live and earn enough to live on, and the mere fact that there is a flat rate of tax on everything he earns will have hardly any, if any at all, repressive effect upon him?—No, it might even stimulate him.

1378. It is when you come to the graded tax that the trouble begins?—Yes.

1379. I follow what you say about the lower grades, the necessity for making the intervals much shorter for the rise in tax. Now, would you help us a little bit with actual experience if you can draw upon it of the effect of surtax? That does at some stage, you say, have a repressive effect?—Yes.

1380. Does it have the repressive effect in the case of fixed salaries? I mean, if a man got nothing but a fixed unalterable salary, that is no commission payment or anything, is there a great repressive effect there from his undertaking some important office?—Well, are you not begging the question by saying that he has got a fixed unalterable salary, and then asking me what would be the effect of taking another important office. That infers he will get some more salary for it?

1381. Yes.—If he was going to get nothing out of it, unless there was some inducement other than money, he would not take it up. If a high executive were remunerated at, say, £10,000 salary and he were promised as a reward, if he did a particularly good piece of work, that his salary would increase to £20,000 but it would involve working 18 hours a day, he would reckon up and say "This £10,000 increase is worth £600 to me because the Government is going to take £9,400. I have to work 18 hours instead of 12 hours and I say no thank you".

1382. Wait a minute, Mr. Bower, we have not exhausted all the things, have we yet?—No, we have not.

1383. Against that you have the hope that at some time there may be a reduction of the tax. He would say I will take the salary now, and the job, in that hope.—We are entering into the hypothetical world again, are we not?

1384. No. I want you to talk from experience if you can.—I should put it this way. If a man were on a salary of so much and the tax were likely to take away the reward he would go on working for a mixed variety of motives—one is ambition, competition with his fellows, another thing is love of power which may appeal to him, not tyrannical power or anything like that.

1385. Because his wife would like to be the wife of a manager?—But he has got to get the money before he can satisfy his wife. The other is he might get an increase in salary if he keeps on working. Although he is not getting much benefit out of it now it is far better to progress forward than slip back. You come up against a man's temperament. Some men will go on working willy-nilly.

1386. Let me put to you another possibility. The man may be under a pension scheme in which the pension will depend upon the salary he is receiving at the end of his employment on his retirement.—That is an inducement, a strong one.

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1387. It is a particular inducement to take a high salary if in the pension scheme concerned there is a quarter commutation provision?—Yes.

1388. You show dissent?—No, I do not dissent at all; it is merely a question of how much bigger incentive it is. If he gets his pension guaranteed by the scheme that is a big inducement for him to work now because he gets that free of tax at the moment; he will pay tax on his pension when he gets it. It is an additional incentive thrown in if he can get a quarter of the value as the form of a lump sum free of tax, that is an additional thing.

1389. The bigger the pension the bigger the lump sum?—Yes.

1390. Now we will leave the salaried people and take the self-employed people. If this second committee of which Mr. Carrington and I am both members dealing with the pensions provision are able to find some scheme whereby they are able to set aside an annual part of their profits to provide themselves with a pension then they have an inducement to go on earning profits even though surtax rates are very high?—Yes, but are you not bugging the question, because so much has to be set aside year by year to buy the pension, he is not going to be taxed at all.

1391. That is what I say. The higher the surtax the more attractive it is to be able to set aside a sum like that.—Quite right.

1392. Because you are setting it aside at the cost of the Government.—Taking a top slice off the income and make the saving all the bigger by having the pension provision.

1393. Would not all these go a long way towards curing a depressive effect once we can round it off with this retirement benefit scheme?—Yes, by doing that you are reducing the progressive effect of the tax.

1394. You would agree with me, would you, that that is really what is missing?—Yes.

1395. It is the ability, out of taxed income while you are earning it, to make provision for your old age and retirement?—Certainly.

1396. Thank you, Mr. Bower. Now I just wanted to ask you about paragraph 16 (c):—

"Casual workers who are liable to pay tax escape by their mobility or by refusing to work when P.A.Y.E. is mentioned."

Is it your experience that what was said at the Old Bailey the other day is true or not, that some of the smaller employers will pay their own men overtime and not deduct any tax?—I do not know whether that is true or not.

1397. And that some workers will refuse to work if tax is deducted from overtime?—Yes, that is true.

1398. You must say yes to the last because you said so in your memorandum—I was thinking more of casual workers. They will not work if there is any suggestion or thought that P.A.Y.E. has to come into it.

1399. Do you think that applies often to the non-casual worker?—You get it this way, and this happens with Co-operation employees or employees who by the nature of their job can finish early. They finish their particular work on which they will automatically pay tax and go and take casual work anywhere else for private individuals or even for another employer. I have been told, this is not first-hand evidence, that at harvest time on the farms there is some kind of general pot going on. The employees of Farmer Brown will knock off work with him at 5 o'clock and then work for Farmer Smith as casual workers for the rest of the evening. The employees of Farmer Smith will work with Farmer Brown for the rest of the evening. That is gossip but I am told it is happening.

1400. That means both farmers do not deduct tax from the overtime paid?—Yes. The alternative is to do what the law asks or obliges them to do, at the risk of leaving the harvest standing in the field.

1401. What would be your remedy for this, Mr. Bower?—I do not know.

1402. We want to know.—That is not a fault of P.A.Y.E. but of not being able to catch hold of these slippery gentlemen.

1403. Would you suggest that we should make it compulsory?—No.—

1404. Wait a minute—for everybody in the country once a year to make a return no matter whether they had income or not, a self return if necessary?—That is one way of doing it, I cannot imagine it carrying very far. It only enables you to prosecute in the case of a false return, but you first have to prove that it is a false return. One thing that is missing is the information which used to be available from the assessor. He would know, living in the same village, that Jack Jones habitually did work for Farmer Brown. But this is a question rather of tax collection than of the mechanisation of P.A.Y.E. Any method is open to abuse unless there are means of enforcing it.

1405. Take (16) E. Mr. Carrington has already put one question to you on that. We know that this provision of the Finance Act of 1948 applies to all directors whether they have got £2,000 a year or not and to all employees who are not directors if they are earning more than £2,000 a year. You say that all employees should be treated the same?—Yes.

1406. For example, supposing, which I am not, I were a director of a window cleaning company and I got the staff of the company to come and clean the windows of my house. I should be assessed as if I had received a sum equivalent to the value of that service?—Strictly, yes.

1407. And if I made my return properly I should put that on my return. Well now, how far would you go with this suggestion of yours, because it is easy to say similar treatment for everybody. After all we are in a realm of fair shares for all, are we not? Would you tax the miners' free coal?—If you could, yes.

1408. You could, you know, it is easy. Are you suggesting that?—Yes.

1409. I do not see how you can help suggesting it if you suggest all employees should be treated alike. We know that tips for waiting staff are theoretically taxable, whether the Revenue, in fact, get the tax on the full amount of tips may be a matter for conjecture, but you would not leave anything out of this?—Oh no, what I said was extend the field so that it covers everybody equally but soften the rules. You cannot run down to the minutiae in this thing. There are all kinds of indirect benefits arising from an employment. There might be a strong argument for doing as the French do, automatically assume that 5 per cent. of the remuneration covers odd expenses.

1410. Yes.—And there in that line of thought you must set that 5 per cent. against the national benefits arising from the employment and cut out the hardship and get somewhere near equality. You cannot possibly run down to all the benefits arising from employment, there is prestige and all kinds of things.

1411. If a shipping company sent one of their staff on a voyage for a holiday over to South Africa, you would tax that?—Logically, yes. It is impracticable because the shipping company would say they sent him to go to look at their invoices over there.

1412. Mr. Millard Tucker: That would be the excuse.

1413. Mr. Kaldor: What about the shopkeeper who purchases the goods at cost price as against the ordinary individual who purchases at the retail price?—He is in trade for himself. The question ought to be what about the shop assistant who gets his goods at cost price. Logically he ought to be taxed.

1414. Mr. Millard Tucker: Then one question on (16) H. You say:—

"Earnings from foreign employments which are paid in the United Kingdom to the benefit of a non-resident person can escape tax both in the United Kingdom and in the countries where the employment is exercised, owing to the conflict of laws in the two countries."

—This is not a frequent case but I can illustrate it by an instance of an American employee of an American business who is sent to the United Kingdom to work in the United Kingdom. He is left on the pay roll of the American company.

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1415. Yes?—Because he is in that situation we look upon him in this country as having a foreign employment and taxable on remittances.

1416. Yes?—He has his salary paid in America and sends over to here as little as he possibly can. He may even be living on expenses, so he is pretty well clear of tax in the United Kingdom. In America he is not treated as being resident in America or liable to tax if he is out of the country for 12 months of the year, so he is neither liable to American tax nor to British tax.

1417. A very lucky person.—It does exist and that is an instance of the conflict of laws.

1418. What are you asking us to say on this?—The only way that could be overcome is to lay down a principle to cut through the confusion we have now that liability to tax on employments should be levied where the employment is carried out.

1419. At the present moment in the illustration you have given, the law has been laid down by the Court of Appeal. That is the case you are thinking of, the case of *Bennet and Marshall*?—That is right.

1420. Do you say we ought to alter that?—Yes, if that which produces the income arises in this country it should be taxed here.

1421. In other words what you want us to say is that the Court of Appeal decision that an employment is situate where the contract of employment is made ought to be altered?—Looked at, not necessarily altered.

1422. And instead the situation of the employment should be where the actual work is being done?—Yes. That would give you a consistent line.

1423. I was not sure if that was what you are asking us to do. Only one more thing: your very interesting suggestion about treating a business as being a kind of impersonal thing so as to enable even individuals or partnerships to retain undistributed profits just as a company so as not to be liable for surtax. That is a very interesting suggestion. What you are really saying, I suppose, is that an individual, although he shall not be treated as having incorporated his business, to use the lay expression, into a company, he shall be treated as a corporation for tax purposes?—Yes.

1424. A new kind of conception of a corporation for tax purposes only?—Yes, tantamount to what they have in India. They call it the registered firm, a registered firm for that purpose.

1425. Yes. Under the Indian system you can register yourselves as a firm and you become, to all intents and purposes, a corporation?—Something like that.

1426. It is very nearly that anyway for tax purposes?—Yes.

1427. It is very interesting, but, of course, there are some people who cannot convert their business or cannot incorporate their businesses. A solicitor cannot, a barrister, a doctor cannot, and I gather now, under the present law, a dentist cannot; he could before. It is a very interesting suggestion but Mr. Carrington has raised one difficulty which is quite obvious. What is to happen when the profits are taken out in the case of a partnership and a partner going out? It is no good putting this

to us without some help as to how we are going to deal with it in detail. Are you at any time going to give us some help by putting forward a really practical scheme?—We had not intended to do so, but we will do it. Whether it will be really practical you will have to judge.

1428. You cannot really throw it all on to us, can you?—No. I was hesitating between taking money out of the business, and, on the other hand, buying the shares in the business, which are two entirely different things which come to the same.

1429. Mr. Millard Tucker: If you will promise to give us some details to help us I am sure all of us, at least I would, speaking for myself, would examine the scheme with interest and eagerness. Thank you, Mr. Bower.

1430. Chairman: Before we say goodbye to you there are two questions I should like to ask, the first arising out of your last answer but one to Mr. Tucker. You were agreed that the essence of what you were asking was that these unincorporated businesses should be treated for tax purposes as if they were incorporated. Assuming your suggestion as to a profits tax is not adopted, should they be subjected to profits tax?—It would follow logically, yes, it is either surtax or profits tax.

1431. Yes. I was also wondering, perhaps you would consider, whether a possible method of dealing with the evasion of surtax is to subject them to profits tax. I have not thought out how it should work.

I quoted the Colwyn Committee this morning. I think I over-stated what they said about the possibility of passing on tax. They approved, I think, the views expressed by Professor Seligman in a paper he wrote on "Income Taxes and the Price Level":—

"In a period of rapidly rising prices, we may have what is commonly called a sellers' market. . . . Being in a position to market his entire output, there will be no inducement for him to cut prices in order to secure a still larger proportion of the total sales. Under such circumstances, indeed, the imposition of a tax of any kind, whether on income or anything else will afford the producer an excuse for asking a still higher price, and the conditions of the market may enable him to hold to that price. But after all, the tax will then be an excuse for, rather than a cause of, the higher prices which he would probably have been led to demand in any event."

What do you say about that last sentence?—I think a business man does not charge the highest possible price (a) because somebody might be round the corner to under cut him and he would lose valuable custom, and (b) he just does not charge the maximum price of the market. He values his connection rather than his to-day's profit, put it that way, because he reckons he has to live in business with these people for years to come and he has to treat them decently if he expects to be treated decently.

1432. Mr. Carrington: On the last question but one of the Chairman's, the profits tax or surtax on profits, you will, of course, have the Lloyd's scheme to look at. That is the statutory scheme where that option is given.—It is very complicated.

Chairman: Thank you, Mr. Bower. We are much obliged to you for giving us so much of your time.

* Cmd. 2490. Paragraph 313 and Part IV of Appendix XII

* [1937] 3 All E.R. 208; 54 T.L.R. 320; [1938] 1 All E.R. 93; [1938] 1 K.B. 591; 107 L.J.K.B. 519; 138 L.T. 74; 22 T.C. 73.

The Witnesses withdrew

2 November, 1951]

Mr. W. R. CLEMENS, Mr. F. T. JACKSON, O.B.E.,
Sir LEONARD BROWETT, K.C.B., C.B.E., AND Lt.-COL. V. I. ROBINS, O.B.E.

[Continued]

Mr. W. R. CLEMENS, Mr. F. T. JACKSON, O.B.E., Sir LEONARD BROWETT, K.C.B., C.B.E., and
Lt.-COL. V. I. ROBINS, O.B.E., on behalf of the National Union of Manufacturers; called and examined.

MEMORANDUM SUBMITTED BY THE NATIONAL UNION OF MANUFACTURERS

1. The National Union of Manufacturers has given careful consideration to the general social and economic questions on which the Royal Commission has indicated that they will be pleased to receive evidence, but has found it not practicable to give useful replies to those questions strictly within the terms of reference which have been laid down for the Royal Commission.

2. The Royal Commission is appointed to enquire into the present system of taxation of profits and income, but is precluded from making recommendations which are not "consistent with maintaining the same total yield of the existing duties in relation to the national income".

3. In the view of the National Union, it is not basically the system, but the weight, of taxation which is the fundamental evil. At the present time, the Government is taking out of the pockets of the people more than 40 per cent. of the national income to be expended in a manner decided upon by the Government and outside the control of the ordinary citizen. Thus, of course, includes all forms of taxation—direct and indirect—and therefore goes beyond the taxes which are the subject of the Royal Commission's enquiry, but these taxes are an important part of what the National Union considers to be a much too heavy burden.

4. In these circumstances, the National Union does not feel that much, if any, relief or encouragement can be achieved by shifting the burden about and lightening one form of taxation merely to increase another.

5. There are, however, certain taxes to which the National Union takes special exception—the Profits Tax on undistributed profits, the Purchase Tax, and the Death Duties in their incidence on the family business. It is realised that only the first of these taxes actually comes within the Royal Commission's enquiry, but the other two taxes are important factors in relation to the general social and economic questions in which the Royal Commission is interested. The National Union considers that as an impost the Purchase Tax has nothing whatever to recommend it and that the present penal rates of the Death Duties, if continued, will do irreparable harm to the industrial structure of this country.

6. With these introductory remarks, the National Union proceeds to deal with the questions on which the Royal Commission wishes to receive evidence, again making it clear that the replies are dictated not so much by the system of taxation of profits and income, as by the present weight of that taxation.

7. As to (a) incentives, the National Union has no doubt that the present rate of taxation is so heavy as to be definitely a disincentive, and that this applies equally to the weekly wage-earner as to the person liable to Surtax at the higher rates.

8. As to the effect of present taxation on (b) risk bearing, it might be argued that a person paying Surtax at the higher rates is not taking much risk if he incurs losses which can be set off for tax purposes against his other income, just as an Excess Profits Tax of 100 per cent. or therabouts undoubtedly encouraged business extravagance. On the other hand, capital in the past has been attracted to the launching of new ventures carrying a certain amount of risk, by the knowledge that if the venture is successful the reward will compensate for the risk. If this reward goes to a Surtax payer in the higher brackets, the net increase in his receipts, after the payment of tax, bears no relation to the financial risk that he may have undertaken. Both in this case, and in the case of the Company liable to Income Tax at 9s. in

the pound, and the Profits Tax, on its profits, the experience of the National Union definitely shows that present taxation is a great discouragement to risk taking.

9. On the question of (c) encouraging savings, there can be no doubt that the weight of taxation today definitely discourages savings. The net income from investments is reduced by taxation to a level yielding a net reward which, with the present inflationary tendency, gives little encouragement to saving. The high level of Death Duties is an added discouragement.

10. As to (d) the control of inflationary or deflationary tendencies, the National Union is definitely of the opinion that the rate of Government expenditure as expressed in the present ratio of taxation is a major cause of the inflationary tendency now so apparent in this country. The Purchase Tax is perhaps the most notable example of this aspect of taxation. Being imposed on an ad valorem basis, it serves to accentuate any rise in prices due to increased costs.

11. With regard to (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment, there can be no doubt that capital investment from abroad is discouraged by the present weight of taxation. One also sees companies moving their head offices from this country to countries overseas so as to avoid taxation at United Kingdom rates on their full profits. It follows that present taxation must be an adverse factor in our balance of payments.

12. The effect of the present taxation on (f), the distribution of personal income, has certainly been to reduce very greatly the gap between the highest possible net income and the net income of the average weekly wage-earner, but how far this can properly be regarded as a "distribution" of personal incomes or as an extraction of an unnecessarily large portion of everybody's income, is a matter of opinion. The National Union very definitely holds the latter view.

13. In reply to question (2), the National Union can see no advantage in linking Income Tax with social security payments and contributions. The National Union thinks that it is highly desirable that the heavy cost of social services to the individual should not be obscured by merging it with the Income Tax. Moreover, there would appear to be considerable practical difficulties in doing so, inasmuch as the Income Tax is a varying liability according to the circumstances of the individual, while the social security payments and contributions are in the nature of fixed deductions or payments.

14. The National Union has already given evidence before the Millard Tucker Committee* on question (3)—the present treatment of companies for taxation purposes, and maintains the views put forward in that evidence notwithstanding the opinions expressed by the Committee in their Report.

15. In conclusion, the National Union feels compelled to repeat the recommendation which it has made more than once made to the Chancellor of the Exchequer that an independent Committee should be appointed to enquire into Government expenditure, including the costs of administration. It is believed that such a Committee could make recommendations which, if adopted, would result in substantial economies in Government expenditure and so pave the way for real adjustment in the burden of taxation. Such adjustments should provide an incentive to greater production, yielding increased profits and income, with the ultimate result that the yield of taxation might be restored even with a reduced rate of tax.

* The Committee on the Taxation of Trading Profits. Cmd. 5185.

2 November, 1951]

Mr. W. R. CLEMENS, Mr. F. T. JACKSON, O.B.E.,
Sir LEONARD BROWETT, K.C.B., C.B.E., AND Lt.-Col. V. I. ROBINS, O.B.E.

[Continued]

EXAMINATION OF WITNESSES

1433. *Chairman:* Mr. Clemens, you and your colleagues represent the National Union of Manufacturers?—Mr. Clemens: That is correct.

1434. Would you tell us, quite shortly, in what respects you differ from the other bodies we have been hearing; whether you represent different interests and, if so, in what the differences consist.—No, my Lord Chairman, there is no difference between the National Union of Manufacturers and the Federation of British Industries. We both represent manufacturers and business interests. We rather say we deal with the smaller type of manufacturer, some 5,300, whereas our bigger brother, the Federation, deals with the larger ones, but we represent the same business interests.

1435. Perhaps you would first tell us, for the benefit of those who have not got this slip in front of them, the names of your colleagues?—On my left is Sir Leonard Browett; the other side of him is Colonel Robins, our secretary, and on my right Mr. Jackson, who is a member of the Taxation Committee.

1436. Before I ask you any questions, do you desire to supplement the short memorandum you put in with any preliminary statement?—No, my Lord Chairman. I think I must state that we feel very sorry that we have not felt able to be more constructive, and that there is a rather negative character in the memorandum now submitted. We kept very strictly to the terms of reference with careful remembrance of the sting in the tail that we must not seek a smaller amount of tax yield.

1437. You will remember what I said to Mr. Bower before, that while we can only recommend for immediate action reductions where we can suggest other sources of revenue, it will be open to us to say that we feel a, b or c should be dealt with when the general position. . . —It might be that we shall have a little more licence under Head B, particular matters.

1438. Do you desire to say anything about excess profits tax?—We cannot express an opinion of the Union as such. It has been our practice always in taxation matters, not in particular in this memorandum, to get the views of the various branches of which there are many, and which contain quite a number of tax experts. Then we develop those views ourselves through our own Taxation Committee. On those two subjects, the capital gains tax and E.P.T. we have not had the opportunity of getting their views. We can only give personal views, and Sir Leonard Browett may like to say something on that.

1439. I will put to you the same questions I have put to the other witnesses. What are your views as to the comparative merits or demerits of excess profits tax and a profits tax?—We have always regarded E.P.T., since it was mentioned during the last few weeks amongst ourselves, as a very bad tax indeed, and we are very sorry to see it might be introduced again. When it was introduced during the war period there was some justification, but we should not like to see E.P.T. re-introduced now in what I call peace-time conditions. Of course, if it is possible to segregate armament or rearmament profits or anything exceptional arising from the condition of affairs now, that would be a reasonable argument for saying some portion should be given back to the Government. But to differentiate between an ordinary trading account, export and home trade, and possible rearmament seems a rather impracticable proposition. The tax itself must fall heavily on a section of business profits which could not justifiably be called profits made in excess under present conditions.

1440. That would be your view even if the proceeds were devoted to other concessions, concessions in other directions of taxation on business profits?—That is a movement of the burden of tax.

1441. Yes. The proceeds of the excess profits tax might be diverted to relieving the burden in other directions.—I do not know if Sir Leonard would like to say something on that?—Sir Leonard Browett: I entirely agree with Mr. Clemens. If you have an excess profits tax, I believe it is practically impossible, I was concerned with the old E.P.D., to segregate profits. You have got to put it on

all business profits in my opinion. As to the relative merits of this E.P.T. as mentioned recently and the profits tax, I do not think one can give an answer to that because we do not know, at least I do not know, on what basis or according to what principles, this suggested E.P.T. is going to be levied. There is some reference to the American system with which I am not familiar, and I think the answer to your question is that we should prefer to wait and see.

1442. Are you prepared, either you or Mr. Clemens, to say anything about capital gains tax, or would you rather reserve any observations of that kind?—I would say this on the capital gains tax, I am giving my personal view, I do not like the idea at all, and I believe if you have a capital gains tax you ought to have a capital losses allowance.

1443. They do under the American system.—Then how are you going to apply this morning's reference to the house sold when a man moves. I have been brought up in the idea that you tax a profit; you tax a man if he carries on a business of buying and selling houses. This capital gains tax, speaking for myself, I believe would be a bad tax. I do not believe that in its administration it would be at all easy. I think you would be very apt to hear of capital losses and not so apt to hear of capital gains.—Mr. Clemens: There is no definition yet as to what is going to be a capital gain, whether it is to be applied to an ordinary business transaction or whether to a speculation on the Stock Exchange.

1444. The suggestion I make is that you should apply the American analogy. I do not know whether you have studied that?—Mr. Jackson would like to answer that. Mr. Jackson: Only about the E.P.T. As an industrialist I have experienced the excess profits duty and the excess profits tax. I think it is a thoroughly bad tax. It leads to no end of wasteful management and business immorality. That briefly is the way I regard it. I believe that it leads to so much waste and that the Revenue really would lose money through charges against the profit and loss account rather than make money out of their gains on the E.P.T. That is only a personal opinion.

1445. Yes. Just one other general question before I pass to your memorandum: You have heard what Mr. Bower said, but I do not know whether you were here yesterday?—Mr. Clemens: No.

1446. Then you did not hear what Mr. Chambers said about the taxation of profits derived by companies in this country from carrying on business abroad, and the suggestion that they should only be taxed on the foreign portion of their business, on their profits remitted to this country. Has your Union got any views on that question?—Yes. I think our view has been that only the amount received in this country should be able to be subject to tax, and that anything earned abroad should remain untaxed unless it is capable of being remitted in some form or other. There is the question of exchange entering into the business for the last few years. The transmission of profits or any other moneys abroad has been so restricted backwards and forwards. I presume you are actually referring to an English registered company?

1447. Yes.—That should certainly be taxed in this country on receipt.

1448. Mr. Tucker put the question yesterday as to whether that was not favouring one company carrying on business abroad vis-à-vis companies carrying on business here who have to pay tax on the whole of their profits whether they use them in their business or not. Have you any views on that, whether you would have thought even so it was in the national interest possibly to allow the change that is suggested in order to stimulate English companies with foreign business?—Sir Leonard Browett: May I make a remark?

1449. Yes, please do.—As my colleague, Mr. Clemens, has said, and we put it before Mr. Tucker's Committee, we hold that profits earned abroad which are not capable of being remitted should not be taxed until they are capable of being remitted. That is one point. The other point on which you have touched, my Lord, is the good old doctrine which has been in existence over a quarter of a century, the doctrine of control. Speaking for myself,

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MR. W. R. CLEMENS, MR. F. T. JACKSON, O.B.E.,
SR. LEONARD BROWETT, K.C.B., C.B.E., AND LT.-COL. V. I. ROBINS, O.B.E.

[Continued]

If a company is demonstrably controlled here and therefore is legally a person resident here, I do not see any reason why, subject to this remittance point I have mentioned, it should not pay taxes in the same way as any other company controlled and resident here and perhaps carrying on all its business within the confines of this country.

1450. Those are the general questions. There are just two questions I want to put to you arising out of your memorandum. Looking at paragraph 8 I gather that you take the view that savings of private individuals nowadays go into securities or fixed interest-bearing securities instead of into risk investments. Have you any more evidence on that?—Mr. Clemens: So far as our members are concerned I cannot say, my Lord, that we have had any correspondence or conversations on that particular point. It is more a question of what was in our minds concerning the ordinary amount of capital investment for the speculative or risk-taking proposition such as the commencement of the manufacture of a new patent or anything of an individual character for which there is not an approved market. My own personal experience has been that it is extremely difficult to get anyone in the higher tax categories interested in new features. They regard the risk they take of having possibly 5d. or 1s. 6d. in the pound left to themselves after the tax is paid as not worth the trouble and the risk of venturing capital. That was in the minds of our Committee when we put that paragraph in as it is.

1451. That may be true as regards the formation of a new business, but generally speaking would it not be true to say that there has been a tendency, so far as existing securities are concerned, for people, including trustees, nowadays to buy equities rather than fixed interest-bearing securities?—You used the word "trustees", my Lord?

1452. I did so deliberately.—I think they are very much bound by the Act which limits their own type of investment. You used the word "equities".

1453. I used it deliberately for these reasons; firstly because I think you will find that there is an increasing tendency to give the trustees very wide powers of investment, and secondly because I believe it to be true that there has been a tendency in the Courts under Section 57 of the Trustee Act to enlarge the powers of investment of trustees, and I would have thought that markets recently have indicated a rise in equities as against a fall, or at any rate a lesser rise, in fixed interests.—I appreciate, my Lord, of course, that the average trustee is anxious if possible to extend the yield which has apparently dwindled in the last few years down to a very small level, and I am thinking of the Dalton 2½ per cent. There has been an increased tendency since that date to invest in what is known in the Stock Exchange phraseology as the blue chip market, the standard dividend or the good performance share, and that has obviously been done in order to get the best income possible. When you deal with a superannuation fund you are definitely fixed there, you cannot go beyond the ordinary trustee securities.

1454. I will leave that to Mr. Carrington, but I do not believe that is quite right. The other point I want to put to you is this. Granted that high taxation tends to discourage investment in equities, inflation tends the other way, is not that really the true position?—Yes, I think one can look at it from that point of view. It is a very general question and one we have not given any—

1455. It is provoked by paragraph 8 of your memorandum.—I appreciate it has come from that.—Sir Leonard Browett: I think the answer to your last question, my Lord, is yes.

1456. Yes, I think it must be. You say the weight of the high rate of taxation definitely discourages savings. Up to a point that is true, but it is not true also to say that the average man as distinct from the very rich man is as anxious as ever to save what he can for his old age? It is true taxation keeps down the possibilities of saving, but I should doubt how far it was widely true to say that it destroyed the anxiety to save.—Mr. Clemens: You are comparing incentives to save with the amount that he can save?

1457. Yes.—That is your point?

1458. Yes.—I think certainly there is always an incentive to save something, because even 5d. a week is something; but the point is that the average income earned in the middle class category has to use pretty well every penny to live in view of the present rising costs.

1459. Chairman: That is all I want to ask you. I will now ask Mr. Tucker to put his questions.

1460. Mr. Millard Tucker: With regard to the question of companies abroad, I am very interested in one reply given by Sir Leonard just now, and I want to take that up and ask you for a little more information. Is it the view of the Union that in the case of a business abroad owned by a British company the question as to whether the profits of that business should be taxed wholly or not taxed at all except upon remittances should depend upon where the business is actually controlled and managed?—Is it a geographical question, as to where it is situated and which country, is that the point?

1461. Let us put it the other way round if it is not clear. Take the legal position, that is a good foundation upon which to start. If a British company is carrying on business wholly abroad, and the company is managed and controlled in the sense that it has a board of directors in this country, it pays tax on the whole of the profits of its foreign business, because that company is resident in this country. If, on the other hand, the control and management is abroad, the company does not pay tax on those profits, because the company is not resident in this country. That is the real position, is it not?—Yes.

1462. Now Sir Leonard said, I took it down, that if the business is controlled here, by which I am thinking he means if the company is resident in this country, it should be taxed in full, that is to say taxed on the whole of the profits.—Sir Leonard Browett: Yes.

1463. Except for this one exception, if the company cannot remit its profits, if it is under some disability through some foreign legislation, and cannot remit its profits, it should not be made to pay tax until it can remit them. That is the only qualification, is it not?—That is the only qualification, but what I said—I am speaking personally now, this is not a matter that has been debated by the National Union itself, it is not a matter that you would say interests the National Union as such to any great extent, because we are in the main an organisation of some 5,300 mostly medium sized and smaller firms—but what I said, giving a personal opinion, was that I believe in the old doctrine of control which, as you know, Mr. Millard Tucker, has run through what must be a large number of cases. Where you establish that a company registered in this country is controlled and managed from this country, then in my view that company should be assessable to income tax under Case 1 of Schedule D on the whole of its profits wherever arising, subject to the remittance qualification which I need not repeat and which you have just most accurately stated.

1464. If that company does move its control, supposing we have not got the provisions of the present Finance Act to worry about, and the company does move its control and management abroad it ceases to be liable under Case 1 of Schedule D.—Certainly.

1465. That means there is a tendency to remove a perfectly good board of directors living in this country and put the day-to-day management and control of the British business in the hands of foreigners.—Mr. Clemens: Of course it does.—Sir Leonard Browett: I should have thought normally—we are studying a case where the actual business and profits is carried on abroad?

1466. Yes.—I should have thought the usual position would have been that the control, if it is moved, would be very liable to be moved to the place where the business is carried on abroad.

1467. Yes.—And that would reduce the liability that we could secure here to the tax on the dividends remitted to this country to such shareholders as are resident here.

1468. The company is not liable at all.—The company as such is not liable at all unless it is charged, I think, as a paying agent.

1469. That is only a representative assessment.—In order to collect on the dividends that come here.

1470. Do you not think that is really a bad thing? You have got to take the actual day-to-day control of the business out of the hands of directors in this country,

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Mr. W. R. CLEMENS, Mr. F. T. JACKSON, O.B.E.,
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[Continued]

and find some foreign residents to take over that supreme control of the business. Do you not think that is bad?—It seems to me that it depends on the facts of each individual case. It may be the same board of directors, or at any rate some of them.

1471. Not in my experience.—I do not know why it should be assumed that it is going to be placed in the hands of foreigners abroad. The place of control may be abroad. That is what we are pre-supposing, are we not?

1472. Yes, I do not know what your experience is, but I know of no case where there has not had to be a foreign board of directors appointed in place of an English board, and I am suggesting to you that that is a bad thing. What I was really suggesting is, do you agree that there should be some discrimination in cases of this kind for the express purpose, the economic purpose, of building up once more this country's foreign investments?—We have in this year's Finance Act a provision that makes it difficult for that removal of control to take place. Personally I do not think that that is a good thing, and I do not think in the long run it is going to be useful to the industry of this country.

1473. I have only one other question. Did you hear Mr. Bower's explanation of what I call the inflation claim?—Mr. Clemens: In relation to depreciation?

1474. Yes.—I could not hear very well personally from where I was sitting.

1475. It is worth while sending our memories back to the first, what we now call the Tucker Committee, if you do not mind the expression. Before that Committee the case on paper was put rather in the way, or could be construed as being put rather in the way, that Mr. Bower mentioned this afternoon, namely that when you are charging depreciation against receipts in an inflationary period you should calculate your depreciation by means of the present-day valuation of the pound as against the actual pound which you did originally expend in buying the particular asset, do you see what I mean?—Yes.

1476. Assume the value of the pound now has been cut to 6s. 8d. in comparison with what it was in 1939; if you bought an asset in 1939 for £100 you ought to treat yourself as having bought it for £300, do you see what I mean?—Yes.

1477. And calculating 10 per cent. of that £300 instead of 10 per cent. of £100?—Yes.

1478. When the hearings took place before the Committee, the actual public hearings, that view was rather let go, and the other view took the place, namely, I am reading now from the Report, that "Industry ought not to be called upon to pay tax upon profits which it has to devote to the maintenance of its productive capacity (measured in real terms and not in terms of money); or in other words that profit used to replace plant at present prices should not bear tax." That is the replacement cost view.—Yes.

1479. Which do you subscribe to now?—To the latter, to the replacement cost view.

1480. And throw overboard the change in the value of money?—I think it is impossible to determine in any practical valuation.

1481. I am not going to ask any more, I only wanted to know what your view was.—As far as I am concerned I certainly agree with the last view of yours.

1482. That is all I wanted to be quite sure about, which view you take.—Sir Leonard Browett: I think Mr. Millard Tucker, that is covered by paragraph 14 of our note.

1483. Paragraph 14 of your memorandum?—In which we say we adhere to the evidence which we submitted to you.

1484. Yes.—And the evidence we submit to you, as my colleague, Mr. Clemens, our Chairman says, is that we prefer the replacement cost basis.

1485. You calculate your depreciation on the replacement cost?—Yes.

1486. Not replacement, as it were, by doubling the present written-down value of the plant?—Mr. Clemens: If you recollect, I do not think it came before any evidence we gave, but we did at one time press for alterations to depreciation allowances before the increased initial allowance came forward, but that was largely met by the later concession which we very much regret to see has been removed.

1487. Mr. Carrington: I have no questions really, but mention was made that trustees of superannuation funds are restricted to fixed interest-bearing investments. I would suggest that that is not quite right.—I was not able to finish. What I had in mind was the case of Local Authorities who are restricted, but I appreciate that every scheme for superannuation in a business is subject to the conditions of the scheme and the trustees can sometimes invest in other than trustee securities.

1488. And also any charitable bodies who have power to alter their bye-laws with the approval of the Privy Council, have to do so with a view to extending their powers.—In other words I think you would agree that everyone who can, without any difficult alteration to Acts of Parliament, would have endeavoured to extend the scope of their dividend return.

1489. And their security.—And their security, yes, as far as that goes. But the dividend has been the one that has been predominantly affected, and the same with investments in superannuation funds for local authorities. People are inclined to take a War Loan at the present time or investments, £3 11s. 6d. per cent., and not consider too much the question of capital depreciation sometimes at the end of a period of the fund or whatever period they expect to borrow for.

1490. Mr. Crick: There is only one point on which I would like a little further information. In reply to the Chairman you emphasised the strength of your view in paragraph 8 that the present taxation is a great discouragement to risk-taking?—Yes.

1491. Are there any particular elements of the tax system which you regard as being especially damaging in that respect?—No, Sir, I think the general weight of it only, because we had in mind particularly the savings of individuals.

1492. You are thinking more particularly of that?—Yes.

1493. Arising out of that answer I have noticed that in paragraph 5 you take special exception to the profits tax on undistributed profits. I think perhaps the key word there is "undistributed" in relation to my question. I want to know whether you have no objection to the profits tax on distributed profits?—We have not raised any specific objection in this memorandum except that we have, I think, before Mr. Millard Tucker's Committee, or in a memorandum to the Chancellor, expressed our general dissatisfaction with the profits tax, and asked if it could possibly be abolished. In this particular matter we have confined ourselves to the undistributed profits: at the present time I think there must be some business tax on profits in addition to normal income tax; therefore too on the distribution of those profits is fair, but not on the undistributed profits, because that is what is required for the business to endeavour to assist the working capital of which there is a tremendous dearth at the present time, particularly among our members of the smaller calibre. That was in our mind when we mentioned it in our memorandum. I am not arguing the merits of the profits tax as a whole, only that portion.

1494. Would not that distinction imply that you do not share the view that the whole burden of profits tax falls on undistributed profits, a view which has been expressed before us very forcibly?—The whole burden.—Sir Leonard Browett: It seems to me that there is nowhere else for it to fall, because it is not deductible from the distributable profits or from dividend, therefore it must come back upon the funds of the business, on the equity if you like, or on the undistributed profits.

1495. So that you really object to profits tax altogether? That is my difficulty, I do not understand.—Mr. Clemens: Yes, I thought I had made that clear, in principle we do object to profits tax altogether. We should like to see

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Mr. W. R. CLEMENS, Mr. F. T. JACKSON, O.B.E.,
 Sir LEONARD BROWETT, K.C.B., C.B.E., AND Lt.-COL. V. I. ROBINS, O.B.E.

[Continued]

it abolished. If it is a question of considering the position under which this Commission is sitting, and the terms of reference as we understood them, we only emphasize undistributed profits tax, the 10 per cent. portion. If we could see that abolished though the tax on the distribution side might still have to remain we would like to do it. That was all we meant there, if that is clear.

1496. Mr. Kaldor: I want to ask one question, arising out of what you said earlier in answer to Mr. Tucker. In the view of your Association, initial allowances, provided that they are adequate, would meet the problem created by the increased replacement costs. Have I misunderstood you?—They would go a very long way to assist. After all the only benefit this business gets is the tax at 9s. 6d. in the pound on that allowance.

1497. And the profits tax.—But we add at least three times its value. The initial allowance gives a certain cash alleviation within possibly 23 months of that date. It does not give complete relief, only partial assistance, that was the objection.—Sir Leonard Browett: I think you described it, Mr. Kaldor, as an interest-free loan. I think I would agree with that, but it does not meet the replacement cost point, as you are not increasing the total allowance. I would accept that.

1498. I understood you to say that you do not share the view that one can increase depreciation allowance because of inflation and the rising prices because it is not possible to do it. I am merely trying to clarify it.—Mr. Clemens: I am referring to the fact that we should like to see increased depreciation allowance, and that, on any other terms of reference, could be advocated. The amount of this allowance is now a question for the Commissioners of Inland Revenue and is outside the purview of the Finance Act. Only the initial allowance was fixed by a Finance Act. That was all we had in mind and we felt that it was rather outside the purview of this Commission.

1499. Chairman: Before we go on may I ask one question arising out of that. You have read the Tucker Report, have you got a copy of it there?—Yes.

1500. Would you look at paragraph 121 on page 43. Have you considered the calculations set out in that paragraph. Have you been able to find anything wrong with them? We are not sure how far it agrees with your last answer to Mr. Kaldor.—I have read it. I read it at the time it was published. I have not studied it since then and it is a little difficult. My reaction at the time was that it was a satisfactory description of the position and I have not had any reason to change my opinion.

1501. Mr. Millard Tucker: You see that we deliberately made a recommendation which, by figures, showed that it would give industry the relief they wanted.—Yes, that was my impression at the time.

1502. All the Chairman was asking was, having examined those figures, can you find any flaw in them?—No.

1503. Chairman: You did not, when you did examine them, find any flaw?—I would say no.

1504. Chairman: That was all I wanted to know.

1505. Sir Harry Gill: Mr. Clemens, the recommendations you are making will mean, if given effect to, a considerable loss of revenue?—We have not made any recommendations to that extent, I deplore the fact that we did not do so because of the terms of reference, except in the general outline, the general preamble. If you are referring to paragraph 5, the taxes which we take special exception to, all those three taxes would naturally mean a loss of revenue. You cannot get away from that position.

1506. You may have heard Mr. Bower this morning make an estimate as to what that would mean. Is so far as there is a loss of revenue, what are your recommendations as to how that should be replaced?—Our general view is that if we can get, say, Government expenditure reduced and tax at the present yield is not required, then the type of tax in that particular category could be relieved, leaving the usual overhead tax, the 9s. 6d., to do away with some of these additional taxes. I am speaking of the first two, death duties is a separate category altogether. We cannot at the moment give you a *quid pro quo* if you had that in mind. We have made a general reference only in this opening preamble. As I said before, we avoided making any special points which would mean a loss of taxation, but tried to deal with the points that were raised in the general character of the memorandum.

1507. Would you support Mr. Bower's suggestion made to us this morning that any loss should be made up by an increase in income tax?—In the rate of income tax?

1508. Yes.—No, we should not support that.

1509. Chairman: Did you wish to add something?—Sir Leonard Browett: Could I mention one thing in about six words, my Lord Chairman? A matter which has been, and still is, occupying the attention of the National Union to a very great extent is the effect of death duties on the family business, the combined effect of all taxation including death duties. I know you can say it is outside your terms of reference, but the additional burden of these contingent death duties, and the income tax, is, in our view, altering for the worse the economic and industrial set up of this country. I believe the family business is, and has been, a very great factor in our industrial progress, and still can be if it is not, as I see it, threatened to be washed out by the whole weight of taxation. I just wanted to say that.

Chairman: Certainly. We are very much obliged to you for coming.

The Witnesses withdrew

MINUTES OF EVIDENCE 6
TAKEN BEFORE THE
ROYAL COMMISSION ON
THE TAXATION OF
PROFITS AND INCOME

SIXTH DAY

Thursday, 22nd November, 1951

WITNESSES

SER. WILLIAM COATES

MR. A. H. ENSOR

MR. W. MANNING DACEY

} *British Bankers' Association. Questions 1510-1755.*



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1952

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TERMS OF REFERENCE

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages: to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer: to consider the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden fairly among the individual members of the community: and to make recommendations consistent with maintaining the same total yield of the existing duties in relation to the national income."

NOTE

For the guidance of intending witnesses the Commission published a list of the main heads under which evidence was invited. They explained that the list was not necessarily exhaustive and that witnesses could put in evidence on questions not specifically mentioned, provided that they fell within the Commission's terms of reference. The list is reproduced below.

A. General social and economic questions

1. Is the present system of taxation satisfactory, or could it be improved, in relation to:—
 - (a) incentives,
 - (b) risk bearing,
 - (c) encouraging savings,
 - (d) the control of inflationary or deflationary tendencies,
 - (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment,
 - (f) its effect on the distribution of personal incomes,
 - (g) other economic and social objectives?

These questions can be considered in relation to the taxation of:—

- (i) salaries and wages (P.A.Y.E.),
 - (ii) profits of businesses and self-employments,
 - (iii) dividends and other sources of income.
2. Would it be advantageous to link Income Tax with social security payments and contributions?
3. Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

B. Particular matters

4. Is the taxation net drawn too widely or too narrowly in relation to:—
 - (a) the taxation of United Kingdom residents (companies or individuals) on overseas profits,
 - (b) the taxation of non-residents on United Kingdom profits,
 - (c) the definition of residence, etc.?
5. (a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particular—
 - (b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?
6. Is the basis of computing income from property under Schedules A and B satisfactory?
7. Should the present rules about deductions for outgoings and expenses be altered?
8. Are the provisions for relief in respect of double taxation satisfactory?
9. Should the present system of graduation by means of the exemption limit, personal allowances, reduced rate relief and Surtax be altered?
10. Should the existing differentiation between earned and unearned income be extended or reduced?
11. Are alterations necessary in the rules governing personal and other allowances?
12. Should the rules about the taxation of husband and wife be altered (a) as regards aggregation; (b) in any other respect?
13. Should P.A.Y.E. be altered or abolished?
14. Should the principle of deduction at source be extended or restricted?
15. Should the method of assessment to Surtax be altered, and in particular should it be deducted from salaries?
16. Are any alterations desirable in the system of administration and the functions of the various statutory bodies or persons connected with taxation?
17. Are any changes in the provisions against avoidance and evasion desirable?
18. Is any alteration necessary in the rules governing the taxation treatment of special classes of taxpayers (e.g., public corporations, co-operative societies, charities)?

THE ROYAL COMMISSION ON THE TAXATION OF PROFITS AND INCOME

SIXTH DAY

Thursday, 22nd November, 1951

PRESENT:

MR. J. MILLARD TUCKER, K.C. (*in the Chair*)

MRS. VERA ANSTEV, D.Sc.

MR. H. L. BULLOCK

MR. W. S. CARRINGTON, F.C.A.

MR. W. F. CHICK

MR. HARRY GILL, J.P.

MR. J. R. HICKS, F.R.A.

MR. N. KALDOR

MR. W. J. KESWICK

MISS L. S. SUTHERLAND, C.B.E.

MR. G. WOODCOCK

MR. E. R. BROOKS (*Secretary*)MR. D. G. DAYMOND (*Assistant Secretary*)

SIR WILLIAM COATES, MR. A. H. ENSOR and MR. W. MANNING DACEY; called and examined.

MEMORANDUM SUBMITTED BY BRITISH BANKERS' ASSOCIATION

1. One aspect of taxation which especially concerns the banks is its effect on the liquid position of the trading community. In business circles, it is widely believed that in recent years the weight of taxation has in fact seriously depleted the liquid reserves of most trading concerns. The Commission will doubtless wish us to show how far that view is substantiated by the evidence at our disposal.

2. By way of background, it may be recalled that in 1945 the economy emerged from the war period in a highly liquid condition. Taken together, clearing bank deposits and the currency and note circulation in the hands of the public were very much higher than in 1938, not only in absolute terms but also in relation to the current level of national income. (See Table I of Statistical Annexes.) In addition, and in spite of 100 per cent. R.P.T., industry as a whole had accumulated substantial reserves of gilt-edged securities, largely as a result of the wartime stoppage of all but the most essential private capital expenditure and of the transfer into Government hands of commodity stocks formerly privately held. Further large additions to the volume of bank deposits were made during the "cheap money drive" of 1946 and in the following year. From the spring of 1948, however, the volume of bank credit remained very stable until the large influx of overseas funds in the autumn of 1950, when the upward trend appears to have been resumed. Meanwhile, both prices and the volume of output have been rising, so that the national income has continued to show a marked expansion. This is, of course, only another way of saying that (as shown by Table I) a steadily growing volume of transactions has had to be financed by a roughly stable money stock, a process which involves a reduction in liquidity, as reflected in rising yields on gilt-edged securities and increased industrial and other borrowing from the banks.

3. For some years past the clearing banks have at six-monthly intervals collected returns of net personal accounts (that is, of credit balances owned by persons less personal borrowings from the banks). These returns (summarised in Table II of the Annex) clearly demonstrate that a marked shift in the ownership of net bank deposits in favour of persons has been in progress for some years past. The proportion of personal balances was already rising during the war years and between June, 1946, and June, 1950, further increased from 33.6 per cent. to 38.9 per cent., a similar trend being shown by the

December returns. This means that since 1946 the net balances of depositors other than persons have in fact declined. Between December, 1946, and December, 1950, clearing bank deposits net of advances rose on balance by no more than £174 millions, but since net personal deposits expended by £174 millions it follows that "other deposits" actually fell by £155 millions. Between 1946 and 1950, in other words, non-personal depositors with the clearing banks experienced in the aggregate an actual diminution in the net balances at their disposal, although the "production account of the United Kingdom" shows an increase between those years of over 40 per cent. in the turnover to be financed.

Statistical Enquiry

4. To throw more direct light on the changes in the liquid position of business during the post-war period, a special enquiry was undertaken in which a number of banks participated. Consolidated figures of unnamed private companies were supplied for this purpose, as it was felt that—apart from unincorporated businesses in which the partners are subject to surtax—it is the small and medium-sized private companies with a capital up to, say £100,000 which are likely to be most adversely affected by taxation. Altogether, a sample of more than 1,500 companies was analysed, including 200 analysed by the Scottish banks. It will be realised that this is not strictly a random sample in the statistical sense; a large proportion of the companies whose balance sheets are in the possession of the banks will in the nature of the case have been recent borrowers and it was not possible, with the limited resources available for the enquiry, to ensure that the sample would give a representative weighting to different geographical regions and types of trading. The material obtained is presented in Table III of the Annex.*

5. No similar statistics have been taken out in respect of unincorporated businesses in which the owners or partners are subject to surtax, but it is the experience of the banks that the pressure of taxation on these unincorporated businesses is even greater than in the case of incorporated businesses, so that the conclusions summed up in paragraph 9 below are applicable in even greater degree to businesses carried on by individuals or partnerships.

* Cond. 8203, Table 33, Item 10.

† Note. Table III is not reproduced in the Minutes of Evidence.

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MR. W. MANNING DACEY

[Continued]

6. The main results of the enquiry are summarised in the following tables:—

(1,514 Companies)	Col. (i) Col. (ii) Col. (iii)		
	1946	1949 or 1950	per cent. of Col. (i)
1. Cash	£936,898	£974,814	90.1
2. Marketable securities	8,706	5,137	59.0
3. Aggregate cash or equivalent resources (1 plus 2)	18,602	14,112	75.6
4. Bank overdraft	13,998	30,589	218.5
5. Net cash and securities (3 minus 4)	4,604	16,478	357.7
6. Debtors and bills receivable	39,160	65,486	167.3
7. Creditors and bills payable	40,662	69,415	170.8
8. Net trade debt position (6 minus 7)	-10,502	-3,937	-37.5
9. Stock	44,893	9,529	21.2
10. Net current assets*	39,656	70,179	177.0
11. Sales or turnover†	278,975	438,334	157.3
12. Capital	47,957	56,198	117.2
13. Reserves	33,636	58,859	175.0
14. Capital and reserves (12 plus 13)	81,591	115,056	141.1

	1946	1949 or 1950
I. Bank overdraft as % of stock	31.2	33.8
II. Bank overdraft as % of turnover†	4.9	6.3
III. Bank overdraft as % of capital and reserves	17.2	26.6
IV. Bank overdraft as % of net current assets (item 10)	35.8	43.6
V. Net cash and securities (item 5) as % of stock	10.4	18.2
VI. Net cash and securities (item 5) as % of turnover†	1.4	3.6
VII. Net cash and securities (item 5) as % of capital and reserves	5.7	14.3
VIII. Net current assets (item 10) as % of turnover†	13.1	14.3
IX. Net current assets (item 10) as % of capital and reserves	47.9	61.0
X. Turnover as % of stock	632	529
XI. Turnover as % of capital and reserves	363	423

It will be seen that in the later balance sheet year, ending in 1949 or 1950, the collective overdraft of these companies was equivalent to more than double the combined holding of cash and marketable securities, giving a collective deficiency of liquid assets equivalent to 14.3 per cent. of the combined capital and reserves (item VII above). In 1946, holdings of cash and securities exceeded the combined overdraft by a sum equivalent to 5.7 per cent. of the capital and reserves. The increased borrowing from the banks is obviously closely related to the increase in the value of the stocks carried, which more than doubled over the period. Given the rise in wholesale prices, the fact that in 1946 stocks were abnormally low, and the marked expansion in production since that year, these figures do not suggest excessive investment in stocks. On the contrary, they point rather to the rebuilding of stocks to a normal working level, yet this has not been accomplished without considerable strain on the liquid position.

7. The figures can be re-arranged as follows:—

LIABILITIES	1946 1949 or 1950	
	£'000s.	£'000s.
Capital	47,957	56,198
Reserves	33,636	58,859
Bank overdraft	13,998	30,589
Creditors and bills payable	49,662	69,415
Total of above liabilities	145,253	215,061

* Sum of items 5, 8 and 9.

† 1,472 companies only; in calculating the percentages appropriate allowances have been made where necessary in other items.

‡ Wholesale prices: 1946=100 1949=226.8 1950=259.7

Production: 1946=100 1949=129 1950=140

(Source: Statistical Digest)

ASSETS	1946 1949 or 1950	
	£'000s.	£'000s.
Cash	9,958	8,974
Marketable securities	8,706	5,137
Debtors and bills receivable	39,160	65,486
Stock	44,893	9,529
Total of above assets	102,717	170,135
Other assets (net)	42,536	44,876
	145,253	215,061

This composite statement shows that over the period the companies included in the sample had to finance an increase of £45,693,000 in stocks and a net decrease of £6,573,000 in trade credit received, making a total of £52,266,000. This was covered to the extent of only £8,241,000 by an increase in capital. In recent years, however, gross profit margins have been abnormally wide as a result of inflation (a large part of the nominal profits being in fact spurious and merely a reflection of the rising replacement costs of fixed and circulating capital). Although both genuine and spurious profits have some heavy taxation, the companies in the sample were nevertheless able to add £25,223,000 to their reserves, so that altogether £33,464,000 (64 per cent. of the amount needed or 73 per cent. of the increase in stocks) was made available by the growth in the companies' own capital resources. A further £4,533,000 was derived from the running down of cash and securities. In all, therefore, sums found from the companies' own resources amounted to £38,017,000 (equivalent to 73 per cent. of the total needed, or 83 per cent. of the growth in stocks). Borrowing from the banks of £16,591,000 (making a total deterioration of £21,144,000 in the liquid position) provided the balance of the amount needed for the purposes mentioned, with a margin of £2,343,000 in hand to finance an increase in other assets.

8. It will be appreciated that the formula used for the analysis covered only the liquid and current assets and similarly excluded certain items on the liabilities side of the balance sheet. Even so, the analysis shows that the additions to the companies' own resources, coupled with the finance obtained by running down liquid assets and borrowing from the banks, were sufficient to finance an increase of no more than about 5½ per cent. in the money value of "other assets, net". It follows that if these companies were in fact able to add more to their fixed assets than is shown by these figures (as might well be necessary in order merely to preserve their fixed capital intact), this can have been done only by incurring additional liabilities not shown in the table (e.g. by issuing new capital) or by investing in the business sums required in specific provisions (e.g. in respect of tax liabilities). The experience of the banks does in fact show that sum held for payment of taxes are commonly used as working capital until paid over, when they have to be replaced by borrowing, probably from the banks.

9. To sum up, the enquiry simply confirms the general impression that in post-war years the increase in capital resources has not kept pace with the rise in the financial requirements of business undertakings. Up to the present the financial position of companies as a whole may not show such acute stringency as is sometimes supposed to prevail, but the danger of serious difficulties is clearly suggested if the inflation of recent years should continue or, alternatively, in the event of any considerable trade recession. In either of these contingencies, it seems probable that large sections of industry would be able to maintain their activities only by looking to the banks for support on a scale which, in many instances, might not be justified in relation to the trader's own capital resources.

Depreciation Allowances and Stock Replacement

10. In seeking to explain the development of financial stringency it is impossible to isolate the influence of taxation from that of other factors. We feel no doubt, however, that the existing systems of basing depreciation

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SIR WILLIAM COATES, MR. A. H. ENSOR AND
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[Continued]

allowances for fixed capital on original cost, and of levying taxation on "profits" which reflect merely an inflationary rise in the price of stock that has to be replaced at the inflated price, are elements of overwhelming importance. We take it as self-evident that both profits tax and income tax as applied to companies are intended to be taxes on income and not on capital. To the economist, if not to all accountants, it appears equally self-evident that the true profits for any period cannot exceed the receipts accruing from the year's trading after providing for the replacement of the physical capital used in earning the profits for the period, i.e. after allowing for the wearing out of fixed assets and replacing circulating capital embodied in the output for the period, both of which, in a continuing business, have to be maintained.

11. There is no need to elaborate the problem involved, since the report of the Tucker Committee* presents an exposition of the issues at stake which is admirable in every respect save, in our submission, the conclusions reached. Thus, in paragraph 193 of their report, the Committee expressly state that in their view the general principle cannot be impugned that "the Income Tax system should give relief in respect of the wastage of all assets that are used up or consumed in the course of carrying on a business." In the succeeding paragraph it is made clear that the wastage the Committee have in mind is a physical one "caused by the natural process of decay or exhaustion through use." Similarly, in paragraph 206, the Committee state their conviction that "a tax which refuses to give an allowance for the depreciation of all business premises is not limiting itself to a tax on income, but is encroaching on capital." In the section of their report dealing with "Depreciation and Wasting Assets," in other words, the Committee accept as a guiding principle the proposition that traders are entitled to maintain their physical capital intact before any profits can arise which may legitimately be taxed as income. But that principle is clearly applicable to the conduct of business as a whole and cannot be confined to the treatment of particular classes of assets. This being so, we submit that in the section of their report headed "Inflation" (Chapter III) the Committee are begging the question in identifying "true profits" (paragraph 132 (d)) with "profits as computed on ordinary accountancy principles," since ordinary accountancy principles (which take for granted the stability of money) are based upon the underlying concept of maintaining intact not physical capital but money capital. It would follow also that the Committee misrepresent the issue in stating, in the same section, that the suggested remedies amount in essence "to a proposal that a business should be relieved altogether from tax on some part of its true profits."

12. We are unable to regard as conclusive the reasons which the Committee adduce for refraining from recommending any form of relief. In large measure, this attitude is based on the argument that any alleviation would involve preferential treatment of particular classes of taxpayers: for example, of trading concerns as compared with holders of pill-edged securities. We would submit that the position of a trader is fundamentally different from that of a person who has chosen to invest his capital in claims to money, thereby accepting the risk of a depreciation in the value of money. Even if that were not the case, we cannot agree that the existence of other hardships or injustices is in itself an argument for refusing to remedy any particular hardship or injustice. We are therefore impressed by the argument that any of the proposed remedies would necessarily be discriminatory even as between different traders or classes of traders: for example, by favouring those who have failed to replace their equipment compared with those who have already done so. In practice, the replacement of equipment is, by and large, a continuous process and injustices inflicted in the past cannot in any case, as the Committee point out, now be remedied retrospectively. As to the future, any appropriate remedy would necessarily benefit most those who suffer most under the present system; and even rough justice is surely better than none.

13. We regret that, for reasons which seem scarcely adequate, the Tucker Committee were not prepared to recommend any of the various methods which have been put forward to give some recognition to the principle of replacement cost as the basis for Inland Revenue depreciation allowances or cognate purposes. There can be no question that remedies which are practicable in

administration can be found since, as the Committee point out, action has been taken to deal with the problem in France and Belgium. Beyond a certain point, indeed, it becomes impossible to cling to ordinary accountancy principles in the face of inflation. Had the inflation experienced in this country been even a little more rapid than has been the case hitherto, there seems no doubt that the problem would already have been faced and dealt with. Yet although the rise in prices since 1939 as been less than in some other countries which have taken action, it must be remembered, on the other hand, that company profits are taxed more severely in this country than in most if not all others.

14. Of greater practical importance than the considerations of abstract equity which figure so prominently in the Tucker Committee's discussion of the question, we would suggest, is the damage likely to be inflicted on the national economy by taxation of capital over a prolonged period.* Official publications give some indication of the magnitude of the sums involved. *The Economic Survey for 1951†* estimates (Table 26) that no less than £700 million will be required by companies and public authorities this year to finance stock appreciation; yet the total of undistributed profits (as amended in the light of the Budget) is placed at only £690 million. In the five years 1946 to 1950 inclusive, according to the National Income White Paper (Cmd. 8203, Table 29, Item 10) sums totalling £653 million were required for that purpose by companies and public corporations. Similar figures are not available to indicate how far depreciation allowances based on original cost fall short of the sums required to finance the replacement of fixed assets at current prices, but some indication may be given by the figures of initial allowances. The effect of the enhanced initial allowances on new capital is to mitigate the over-statement of profits due to the inadequacy of allowances in respect of existing capital installed when prices were lower. It seems reasonable to suppose that total depreciation allowances, even after the inclusion of initial allowances, are not larger than the Inland Revenue considers justified on the facts. Initial allowances in 1950 totalled £260 million (Cmd. 8203, Table 2, Item 10). That figure may provide some measuring-rod for the amount of capital subject annually to taxation as "profits" in earlier years, and of the burden that will be reimposed by the withdrawal of the initial allowances as proposed in the Budget. The Commission naturally needs no reminding that the Tucker Committee recommended an increase in initial allowances as a substitute for any of the proposed methods of giving recognition to the principle of replacement cost.

Other Aspects of Company Taxation

15. In the previous section it was shown that in periods of rising prices company profits as computed on ordinary accountancy principles greatly exceed the true profits remaining after the maintenance of physical capital. It is the general experience, however, that profits as computed for tax assessment invariably exceed those computed on accepted accountancy principles. This arises mainly from the ordinary commercial practice of charging to current earnings provisions which are deemed necessary and prudent for depreciation and diminution in value of assets, provisions in respect of future expenses which should be charged against current revenue, and other provisions of a similar kind. The amounts provided from profits for amortisation, for example, are not allowed as a deduction for income tax purposes although bankers insist on such provisions being made from a company's taxed profits. Shops, offices and premises in which a wholesale business is carried on have not hitherto been regarded as "industrial buildings" for the purpose of the Income Tax Act, 1945. It is hoped that the Royal Commission will endorse the recommendations of the Tucker Committee that a depreciation allowance should be given for all commercial buildings and a writing-off allowance be given in respect of leaseholds and certain other wasting assets.

16. The most serious effect of the over-statement of company profits in assessing liability to taxation is the restriction which it imposes on the ability of companies to accumulate sufficient resources for modernisation and expansion, or adequate financial reserves. The subject of adequate reserves is one that is of special importance to

* See e.g. *The Economist*, May 5th, 1951. Pages 305-6.

† Cmd. 8195.

* Cmd. 8189.

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[Continued]

banks. Financial institutions occupy no privileged position in this respect; in their case, as in that of other companies, all transfers to reserves, published or unpublished, can be made only from taxed profits. The public interest would obviously suffer if the weight of taxation should make it difficult to maintain reserves of sufficient strength. This aspect of the matter should not be overlooked in any concessions which the Commission may recommend with the object of alleviating the pressure on company reserves generally. Such concessions, in other words, should not be related exclusively to the maintenance of physical capital.

17. The provisions of the Income Tax Acts regarding the admissibility of charges against revenue are mainly of a negative character, the general implication being that no sum may be deducted from earnings except such "disbursement or expenses . . . being money wholly and exclusively laid out or expended for the purposes of the trade, profession . . . or vocation." The strict interpretation of this kind of restrictive legislation leads to the inadmissibility of certain expenses as deductions for taxation purposes which would be considered as proper charges to revenue in current accountancy practice, being incurred in or in connection with the conduct of the business. The taxation principles on which deductions for expenses may be allowed should be more clearly defined and widened in scope in a codification of the Income Tax Acts on a positive basis.

18. The present arrangements for the taxation of income arising abroad are considered unsatisfactory by various members of the British Bankers' Association operating in overseas countries. It is recognized that the recent extension of Double Taxation relief has done something to adjust the incidence of taxation between companies operating in this country and those trading abroad. Nevertheless, the network of Double Taxation agreements is not complete and the position cannot in any case be satisfactory so long as taxation in this country is so much higher than in nearly all others. The Australian banks resident in the United Kingdom, for example, emphasize that in effect they bear the higher United Kingdom rate of tax on their profits earned in Australia, whereas the banks not so resident bear the lower Australian rate. They desire to draw attention to the serious effect, particularly in relation to retained profits, which the existing taxation disadvantage has on their ability to develop their businesses in Australia in competition with banks not so resident.

19. One matter of particular concern to banks operating in some overseas countries is the present system of taxing as current profits income earned abroad which for various reasons, such as the currency regulations of the overseas country, it may be impossible to convert into sterling and remit to this country. This is not only deemed inequitable but must in the nature of the case act as a deterrent to enterprise overseas. It is hoped to submit detailed evidence on this and related questions under Section B of the Heads of Evidence and in this connection we would refer to the representations already placed before the Tucker Committee by the Bank of London and South America Limited and by Lloyds and National Provincial Foreign Bank Limited. Meanwhile, we would emphasise the view that income should not be taxable until it becomes either realized or realisable sterling income and should be assessed for tax only on the basis of the rate of exchange ruling at the date when it first becomes remittable or is actually remitted, whichever may be more favourable to the Revenue. Alternatively, the Commissioners should accept an assignment of the appropriate proportion of the blocked funds in satisfaction of tax liability.

General

20. The foregoing sections of this memorandum have dealt exclusively with the taxation of companies and thus relate to Question A.3 of the Commission's questionnaire. It is not proposed to submit formal evidence on the wider issues raised in Question A.1, though we hope to be able to testify on some of the "particular matters" (Section B of the questionnaire) which relate to these wider issues. Meanwhile, we should like to place before the Commission some brief observations on the issues raised in Question 1 as representative of banking opinion on these matters.

Incentives.

21. Beyond a certain point there is a direct conflict between the need to provide incentive and the attempt to redistribute income by means of progressive taxation. Banking opinion is in no doubt that with the greatest steep graduation of rates of direct taxation that point has been reached and passed. It is considered, in other words, that a reduction in direct taxation is urgently required in the interests of incentive. If that cannot be made possible by economies in public expenditure, it points to the desirability of shifting over to some considerable extent from reliance on direct taxation to indirect taxation (e.g. through the withdrawal of the subsidies which at present overburden the budgets both of the central government and of local authorities, and which may be regarded as negative indirect taxes). It is held that the present adverse effect of taxation on incentive might to some extent be mitigated by a smoother graduation of the tax curve and by simplification of the P.A.Y.E. system. We hope to submit evidence on these points in answer to Question B3 and B.13.

Risk-bearing.

22. We view with disquiet the factors in the present situation tending to reduce the supply of risk capital and, on the other hand, the encouragement afforded to companies by the incidence of profits tax to finance themselves by means of loan capital rather than equity or preference capital. It is considered that the weight and incidence of taxation place insuperable obstacles in the way of the accumulation of capital for the financing of new enterprises and expansion. It is difficult to exaggerate the debt owed by British industry and national prosperity to the enterprise, initiative and vigour of individuals who free small beginnings have built up great commercial and industrial concerns—men of the type of Jesse Boot, Thomas Lipton and William Morris. These geniuses have been thrown up from the turmoil of competition and have built up vast businesses because they knew how to provide the public with something cheaper and better than they had before. Such enterprises have carried British products and trade all over the world. But all their ability and enterprise would have been unavailing if they had been unable to accumulate the necessary capital in growing volume out of their retained taxed profits. If such leaders cannot emerge British industry will become stereotyped and stagnant, and the prizes of industrial efficiency will pass to other nations whose taxation policy is less suicidal. The treatment of small businesses is in striking contrast with their importance in the national industrial structure: the reliefs in respect of liability to profits tax have been virtually unaltered since the introduction of the National Defence Contribution in 1937. A review of these arrangements and concessions in the changed conditions of the present time is overdue.

Saving.

23. Evidence has been submitted earlier in support of the view that present taxation, even in a period of abnormally high profits, leaves companies with insufficient reserves for their financial requirements. In this connection, we may perhaps be allowed to refer the Commission to the view expressed in the Colwyn Committee Report (paragraph 416) that when taxation falls on company reserves "it entrenches upon a form of saving which is of special value to the community." Official documents testify to the relative decline in personal saving. Thus the latest National Income White Paper (Cmd. 8203) estimates net personal saving (i.e. gross personal saving less taxes on capital) at £144 millions both in 1938 and 1950; but in the former year this represented saving out of personal incomes totalling less than £5,000 millions and in the latter year out of incomes exceeding £11,000 millions. It is considered that in the long run its oppressive effect on private saving will rank among the most serious consequences of the present level of taxation. Evidence provided by one bank shows that the sum invested by its employees in savings securities has in the past two years fallen to less than one-eighth of the figures reached in the years 1941-4. So far as the clearing banks are concerned, the 1947 appeal to "Save the Bank Way" has met with negligible response.

The Balance of Payments.

24. We view with great concern the recent decline of many important companies operating abroad (especially mining companies) to uproot themselves in order to obtain

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the benefit of more favourable taxation overseas. The incidence of profits tax is considered a major factor affecting the inflow and outflow of capital. Should the exodus continue it will jeopardise the future of London as the centre of world mining finance; United Kingdom shareholders will have only a proxy vote; directors resident here may well be replaced by others with far less experience and even the executive control may easily pass into other hands. Our valuable invisible earnings for banking, insurance, shipping, etc., services will inevitably suffer. Thus we can ill afford. It is doubted, on the other hand, whether such measures as the penal provisions of Section 36 of this year's Finance Act are calculated to improve the balance of payments, since they are likely to deter some traders from taking advantage of favourable trading opportunities overseas that would redound to the benefit of this country and to act as a grave discouragement to any movements of capital into this country that might otherwise be contemplated. A preferable alternative, in our view, might have been to limit liability to U.K. taxation to the aggregate of the profits originating in this country and profits brought home for distribution by way of dividends or otherwise.

25. In the post-war period there has, of course, been considerable emigration of persons as well as companies. A decision to take up residence abroad is usually prompted by a variety of motives and, while the weight of taxation in this country often figures among them, it is difficult to say what influence should be assigned to this factor. Escape from the burden of United Kingdom surtax, in

particular, is obviously a matter of no small importance to those in the higher tax brackets. Nevertheless, banking opinion inclines on the whole to the view that in the majority of cases taxation has not been the deciding consideration, though some banks report very large numbers of enquiries regarding the incidence of taxation in the Dominions and other parts of the sterling area.

26. It is considered that the balance of payments is adversely affected by the doctrine of "residence" for tax purposes as applied to visitors from overseas, many of whom (especially former residents of this country) are thereby induced to curtail their visits to this country. The status of "visitor" should be defined with precision and an alternative basis be provided to simplify the calculation of liability to United Kingdom tax of visitors who became technically "resident." It is hoped to submit detailed suggestions under this head in answer to Question 4 (c) of Section B of the Heads of Evidence.

Linking Income Tax with Social Security.

27. On the whole, banking opinion is impressed by the argument (associated with the name of Lady Rhys Williams) that a considerable saving of administrative work—mostly by Government departments but also by employers—might be achieved by linking income tax allowances with social security payments. For this reason it is felt that such proposals should be sympathetically considered, though any loss of identity of the present social security payments and of the insurance basis to which they relate would be a matter for regret.

ANNEXE

TABLE I

1	2	3	4	5	6	7
Cleaving Bank Deposits (1)	Currency and Note Circulation (1)	Deposits, Notes and Coin (Col. 1 + Col. 2)	Gross National Income (2)	Deposits, Notes and Coin (Col. 3) as per cent. of Gross National Income (Col. 4)	"Production Account of the United Kingdom" (1) £ million	Deposits, Notes and Coin (Col. 3) as per cent. of "Prodn. A/c of the U.K." (Col. 6) per cent.
£ million	£ million	£ million	£ million	per cent.	£ million	per cent.
1938	2,277	446	2,723	51.8	6,638	41.0
1945	4,692	1,263	5,955	64.9	D.A.	—
1946	5,097	1,343	6,440	71.4	11,758	54.8
1947	5,690	1,361	7,051	72.6	13,196	53.1
1948	5,913	1,259	7,172	67.1	14,669	48.8
1949	5,974	1,348	7,322	63.0	15,604	46.2
1950	6,004	1,355	7,359	60.7	16,561	43.9

(1) Annual averages. (2) 1945 Cmd. 7371; other figures Cmd. 8203. (3) Cmd. 8203, Table 33.

Sources: Statistical Digest and National Income White Papers.

TABLE II

CLEAVING BANK DEPOSITS

PROPORTION OF NET PERSONAL ACCOUNTS*

	June Returns	December Returns
	Per cent.	Per cent.
1942	28.6	28.7
1944	31.0	30.6
1946	33.8	32.7
1948	37.1	36.4
1950	38.9	36.3

* I.e. Personal credit balances less personal borrowings as a percentage of total deposits less advances.

	GROSS DEPOSITS		GROSS DEPOSITS LESS ADVANCES				
			TOTAL		PERSONAL		OTHER
	£ million	Change in Period £ million	£ million	Change in Period £ million	£ million	Change in Period £ million	£ million
June Returns:							
1946	5,045		4,162		1,406		2,756
1948	5,935	+910	4,614	+452	1,711	+305	2,903
1950	6,000	+65	4,352	-262	1,695	-18	2,659
1946 to 1950		+955		+190		+287	
December Returns:							
1946	5,685		4,705		1,580		3,125
1948	6,200	+515	4,822	+117	1,754	+214	3,067
1950	6,368	+168	4,724	-98	1,714	-40	3,010
1946 to 1950		+683		+19		+174	

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EXAMINATION OF WITNESSES

1510. *Mr. Millard Tucker:* Before we begin the proceedings of the afternoon there is one announcement I have to make, and I make it with a considerable amount of personal regret. You will recall that Lord Cohen was recently appointed a Lord of Appeal in Ordinary; that, of course, is a judicial appointment, the duties of which will take precedence over other duties, and I am sorry to have to say that as a result Lord Cohen has had to relinquish the Chairmanship of this Commission. Pending the appointment of a new Chairman, my colleagues have asked me to occupy the Chair, and I am sure I shall be voicing the feelings of the public who are interested in this inquiry as well as the feelings of all my colleagues when I say it is a matter of great regret to us that we have had to part with the services of Lord Cohen.

Now, Sir William, Mr. Ensor and Mr. Dacey, you are here to give us the benefit of any extra views we would like to have based upon your memorandum which, of course, we have all read with care. There are a few questions which some of the members of the Commission would like to put to you, and I will begin with one or two points upon which I should like just a little enlightenment myself.

The first part of your memorandum, which contains this statistical information, we gather is designed to show us that as the result of circumstances, of which I suppose taxation is an important one, the capital resources of industry have been unduly depleted. That, I think, is the object of the first nine paragraphs of this memorandum?—Sir William Coates: That is so, Sir.

1511. You do not, of course, say that that is entirely a result of taxation?—No.

1512. Whatever other causes there may have been your view is that taxation is one of them?—Yes, one of them.

1513. And whatever have been the causes of the depletion of resources by taxation one of them, I suppose, is the total amount of the tax which has been demanded and taken out of the coffers of industry?—Yes.

1514. Two things can bring that about; one is that the basis of computing the tax is a wrong one, and the second is that the rate is in any event too high.—Yes, Sir.

1515. So far as it is due to the rate of tax being too high you appreciate that we do not want particularly to discuss that aspect of the matter?—No.

1516. We want to consider the first aspect, and your contentions are that industry is being taxed on more than its real and true profit?—That is so.

1517. We have read your criticism of the conclusions which the first Committee arrived at upon this basis of depreciation allowances and the cost of replacing stock. Now is it true, I just want to say whether you agree with this, that whenever a person turns any money in his possession into stock at that stage there is no loss anywhere?—No, not at the moment.

1518. Merely a change of assets. If the stock which he is buying, in order to replace stock that was sold, is at an inflated price that would be because the prices generally had risen in more or less all sections of industry, would it not?—It would not necessarily follow in any section of industry if you apply equal . . .

1519. In his own line of business?—Yes, in his own line of business.

1520. Then presumably the stocks he had in hand would equally have been sold at an inflated price?—When they come to be sold, yes.

1521. And because he credits his accounts with the sale of stock at an inflated price although it is, in fact, the price he does receive, do you say there that at that stage his profit will be overstated?—Yes.

1522. That is what I want you to deal with. Would you just explain that in a little more detail for my benefit; why at that stage is the profit overstated?—I think I would say that in a sense when the manufacturer is selling for profit he is really selling two things, or three at the later stage, but for the moment on this point he is selling two things. He is selling really first and foremost the

services or the additional values that he has put in those goods, and secondly he is selling the raw material or the stocks that he has purchased for that purpose. His real service to industry is in the first factor. But owing to the continuous movement of prices through inflation he makes the second profit, that is the artificial profit, the factor of the difference between the cost at the time when he purchases and at the time when he sells; that is not a true profit. If you turn it into real things it is quite certain that it is not. Six bales of wool at one date are probably very similar in value, in "real" cost, to six similar hags a month later, but he has later on, in order to render continuous services for his customer through his own activities, to acquire his further materials.

1523. Yes, and that will come in, of course, as . . . taxable profits, and it is not real profit. It will be obvious in the case of seed corn.

1524. You were telling us that it is not really a profit. I would like to hear a little more on that.—May I take as illustration the holding of a house in possession in 1914: in the course of the First World War prices rose considerably. The man at the end sells it because he has to change his residence and he gets a price which is far in excess of what he has paid. His friends congratulate him on the profit he has made, but he says, "I have made no profit at all, I have got to buy another house with equivalent accommodation near my new job, or wherever I am going or for whatever reasons, and it will cost me what I have received. I still have the house with X rooms and Y bedrooms and so forth and it is in reality almost the same house on a different site. Where is my profit?"

1525. Let us analyse that a little bit more, shall we, because I am very anxious to understand the point of view and not to misunderstand it in any way. Let us talk in figures for the moment, I find it easier to talk in figures for this purpose. The man bought the house in 1914, say, for £1,000, sells it for £5,000 and the money buys a similar house in another district of equivalent value for £5,000. Those are the transactions we are considering, and you say, "Where is the profit?" He ends up with an asset worth £5,000.—In money value.

1526. In money value. He begins with having £1,000 in the bank.—In money value; and the purchasing power of the second theoretically is one-fifth of what it was.

1527. Yes, I know, but leave for the moment the purchasing power because I am trying to get the first part of the sum right.—Yes, I admit there is money value.

1528. Expressed in terms of £s. in 1914 he was worth £1,000. Expressed purely in terms of £s. no matter what the purchasing value is he was worth £1,000 and today he is worth £5,000 but with a £. that buys less than it did in 1914.—Yes, Sir.

1529. The answer is he has not made a profit in your view because his purchasing power is no more now than it was in 1914?—That is so.

1530. That is a true analysis, is it? I want to be quite sure it is because it helps us to think on this problem if one does analyse this down to the bottom.—Unless my colleagues wish to disagree with me.

1531. I hope they will if they do.—Yes, so do I because we are tripartite.

1532. You switched, as it were, the problem from one of what I would call circulating capital, that is, stocks, to fixed capital when you are dealing with houses, buildings, and that sort of thing.—Yes.

1533. I want you to say you would to help us by applying the same thing to a man starting a business in 1914 with £1,000 worth of stock. For the moment would you deal with a man who does so work on that stock at all but merely buys to sell again.—I cannot conceive circumstances in which he buys and sells again and does not render any service at all, otherwise he would not be in business.

1534. Suppose he does not render any service to the goods?—But he does to his buyer, it need not necessarily be to the goods, unless they are services which somebody will pay for and in which the goods are a concomitant.

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1535. I would like to take a concrete illustration, take a grocer who buys and sells articles of food, mostly in tins. He starts in 1914 with £1,000 in the bank, and he buys £1,000 worth of goods. He rents a shop, he works in the shop himself and then begins to sell his goods to the public. It goes on year by year, and he must make some form of profit, I suppose, because he has to make something out of which to provide for his own livelihood. He will not just be all square at the end of the year with no surplus at the end of the year over the position at the beginning of the year, will he?—No.

1536. Now come to the beginning of last year and say he keeps about the same volume of stock, and he keeps a stock there worth, say, £3,000. I am taking it that a £ would be worth 5s. 6d.—Yes.

1537. During the year the purchasing power of the £ drops still more until it becomes only 5s. 4d. If that process of dropping begins at the beginning of his year he will begin to sell his £3,000 worth of goods for £6,000.—Or some higher figure.

1538. Or some higher figure, and at the end of the year he will have sold all his goods, he will have got £5,000 and then he has to buy another £6,000 worth.—To replace the stock he has sold, yes.

1539. But has he? Has he got to buy as much as £6,000 worth in that event because presumably in the price he gets for the old goods there will be some element of money, no matter how much it is, which he keeps for himself. If he puts all his gross receipts into stock afresh he is putting his past profits into stock as well as his base stock money.—I should not have agreed with you so readily. You say he had £3,000 of stock at the beginning?

1540. Yes.—He has £6,000 at the end. A part of that would be in respect of his services.

1541. Yes.—And therefore he will not need £6,000 of stock.

1542. No.—The services will, of course, include his own personal remuneration.

1543. Yes.—You started off with the predication of circumstances in which no services were rendered and the grocer I take it renders some service to the public in respect of which he must be remunerated so you can deduct, as you say, from the £6,000 you have in hand at the end, the money that is required for that remuneration of the services he has rendered.

1544. Upon that, in the present circumstances, he would pay tax, that being his profit.—In respect of services only.

1545. Yes, whatever figure you are deducting to represent his services.—He would certainly pay tax in respect of that.

1546. Is there anything wrong in that?—There is nothing wrong in that as far as I can see because he will pay out of the same £5 as he has earned.

1547. Where is the error that you suggest exists?—In relation to that part of his total turnover which is required for the replacement of his stocks, that which is a profit arising from inflation and rising prices.

1548. But I thought you agreed with me that when money was put into stock there was no profit or loss at that stage of the transaction, merely a change of one asset into another.—I think the record will show that I said "at the moment", but you predicated then a year which is a convenient period for accounting.

1549. We have to take some period, have we not? We cannot take a man's lifetime, and wait until the end of his life.—I was assuming, perhaps unjustifiably, one of your premises was that the inflation was continuous so that prices were rising slowly during the year.

1550. Do by all means let us assume that it is going on at a perhaps slow and sometimes imperceptible rate. If it is an imperceptible rate it does not really matter very much.—Yes.

1551. Does it?—Yes, when you take a period of the year in which there is time for it to be accumulated, because it is on the proceeds of the year and the circumstances in the year that the tax is levied both on the inflationary profit and the profit for the services.

1552. What I want to get from you, if you can help me, is what part of the man's total receipts during the year you would say is not to be considered a profit at all,

and exactly why. Given what you say, that any part of the money representing that profit which is turned into another asset of equal value produces neither profit nor loss, what part of a man's total receipts from his shop do you say are not to be treated as his profit?—To determine that accurately you might need a very detailed analysis of his sales in respect of selling prices and the comparative buying prices also an analysis during the year of his profits in relation to various sections of the year.

1553. That is where I am getting to next. In making that comparison of the purchasing power of the £ at what date do you compare the value of the £ when he receives it, at the beginning of the year or some previous year, and if so how far back?—I should have thought that was a continuous process during the year in relation to specific goods. He buys seed at one price, say, at the beginning, and sells it, and there is a difference. He buys seed again the next time on that sale at a new price. There at once you have a movement in the price which if repeated through the year is part of the inflationary influence.

1554. How are you going to ascertain in a case like that what the man's true profit is?—You are putting to me the problem of the Revenue, or the problem of the individual?

1555. No, I am putting to you now the general problem. If you say compare the man's wealth at the beginning of the year and the end of the year and you find that it is greater at the end than at the beginning showing in some way or other, expressed I agree in terms of £s, that there has been an increase, how do you ascertain how much of that increase ought not to be treated as profit?—You could do it in precise detail for any one individual business at a great cost of labour. I think if I were dealing with the problem generally I should take refuge in an index number which is most closely associated with the particular industry I was dealing with and apply that to my material and stock during the year.

1556. Week by week, month by month?—No, stock at the beginning, and I would want stock at the end and there may be some extraneous influences, but it may be proper to take an index number as showing the inflationary movement, and find out the stock which I had sold in the year.

1557. And supposing the stock happened to be, of course it never will be, exactly the same quantity at the beginning of the year as at the end, and of exactly the same type, and the purchasing power of the £ in relation to that stock has gone down by a half, how much would you say ought to be deducted from what I call the arithmetical profit that the profit and loss account would show?—I am afraid I have not really, on behalf of the British Bankers' Association, addressed my mind to the precise manner by which I would do this, but that there is an inflationary profit I have no doubt at all. I have not gone into the problem of how over a broad field I would attempt to ascertain it.

1558. You see, what we must not forget is that if you take the receipts in depreciated £s your profit will be expressed in depreciated £s too.—Yes, I agree.

1559. And your tax will be payable in depreciated £s as well.—That is true, but that does not affect the loss of capital.

1560. Where is the loss of capital?—The loss of real capital. The tax is levied on the inflationary profit.

1561. I am still puzzled and am groping for the exact analysis of this argument. It sounds all right, but it does require testing, of course, does it not?—I do not think there would be any problem were it not for the use of money. If you carried out your transactions in some simple business like growing a field of corn, where you put aside the seed corn and you reckon your profit in terms of what you had to begin with and that which you sold or had in stock other than your seed corn. The money system brings in the seed corn at its current market value; and because that is higher than it was at the beginning a profit emerges on it. You pay it away and therefore in real things you pay away £s of your capital.

1562. Let me take your own illustration of seed corn. We will assume the man started with one field. Supposing at the end of the year he decided to open a new field so

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that he will have two. He will retain twice the amount of seed corn for that purpose.—Yes, if he is starting a new business in the sense that he has another field.

1563. It is an extension of his activities.—That is a new activity, a new business to some extent.

1564. The seed corn attributable to the second field you would treat as a profit, would you?—He has taken some of the proceeds of that first year to be the seed corn for the second. I say he has invested more capital because he now has two lots of seed-corn instead of one.

1565. He has taken part of his profits of the first field and applied them as capital in the second business?—That is right.

1566. Would he be relieved from liability to tax on that profit be so applied?—I am not quite clear which profit you are talking of.

1567. The second lot of seed corn. Take it in your illustration, follow your first one, that seed corn is a base stock which goes all the way through his life, is it not? That is your view there?—Yes.

1568. I am taking the one where there is an extension, where he requires a bigger amount of corn to be kept in hand. Is that a profit on his first?—Take the first year, he retains his seed corn and he will pay tax on the balance which is the profit.

1569. Yes.—And he will pay it on corn less so much and then out of his taxed profit he will take the second batch for seed corn.

1570. That is what I thought.—Then the process starts again, but there is no essential difference between that and the first instance. He will have paid his tax, he will have invested his money like all of us do out of our taxed moneys. We are not allowed to invest with untaxed.

1571. No, then is this really coming down to a suggestion that in all cases where stocks have to be maintained whether for manufacturing businesses or merchanting businesses there should always be a base stock?—Any addition to base stock may only be made out of taxed profits.

1572. That is the same thing.—I want to be quite clear with you, Mr. Chairman.

1573. Take the first year, you say, "I am going to elect to keep bigger base stock because I am extending my activities".—Yes.

1574. You agree that the first addition to that new base stock must come out of taxed profits?—Yes.

1575. So far that is agreed. Thereafter it should be, if he does not extend base stock, on the footing of twice the amount of seed corn that he first required?—I am sorry. . . .

1576. He started with one lot of seed corn.—I have said if he did not extend.

1577. If he did not extend after the first extension.—Yes.

1578. After the first extension if he remained constant for the remainder of his business life twice the amount of seed corn would become his base stock?—Yes.

1579. What would happen when he ceased to carry on business and sold his stock? Has all that profit, as it were, come into one year?—When he sells his stock?

1580. Yes.—Are you suggesting that at that time he has made a profit in respect of his stock?

1581. Yes.—He has in money terms, but not in real terms, as in the case of the house.

1582. When he ceases to carry on his business?—When he ceases to carry on his business.

1583. He will not want to buy any more stock, will he?—No, but in terms of reality it is only the same real value of purchasing power as it was in the beginning, so where is his profit?

1584. Is the suggestion that we ought to express a man's terms of profits in money first and then convert the money into some standard figure representing the purchasing power of the £ at some given date?—Yes, to endeavour to get at real values.

1585. What date would you choose as the date to fix the standard of the purchasing power of the £?—I think that carries me a long way away from my capacity here today as a banker.

1586. This is involved in your proposition it seems to me, is it not? You cannot stop short.—Not the choice of a particular date. We come to lay before you an argument in principle.

1587. I know, but what wants testing is the practicability of the principle among other things.—I should leave that to my economist and taxation friends as to what that date is, but, of course, one could see that one would not go back to the days when one paid a penny an hour for labour in building Salisbury Cathedral or even earlier. It would have to be governed by what was reasonable, I think.

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1589. Yes, the physical assets. There seem to be two views about this now, one is that the assets should be, as it were, written up to their present day value in terms of £s, should then be written down by the amount of their past life on a proper depreciation basis, and then from now on the depreciation allowance should be given on that revised written down value. Is that your view as to what should be done?—You said there were two views.

1590. The other one if I am right, I hope I am right, is simply to double the present written down value of the assets and begin to charge depreciation on that basis. Have you thought out which you prefer?—To be frank we did not come today, or we did not regard your invitation to come today, as one which suggested to us that we should not only complain of what we thought was erroneous but that we should also provide the solution, because we do recognise that in any solution on matters of this kind there probably must be broad compromises. There is the interest of the Revenue, the interest of the taxpayer, the interest of the administration and the whole complex of circumstances which need to be considered in relation and inter-relation to one another. We did not presume to regard ourselves as being as qualified to do that; it is a matter for the experts of the Inland Revenue once the principle had been admitted, the principle of correction.

1591. I will not bother you with too much detail, but I will just ask you to consider this. In considering what profit a man has made during the course of the year, because that is what we have to ascertain, you agree that allowance should be made, in addition to ordinary expenses and outgoings, for the difference between the value of his capital assets at the end of the year and their value at the beginning of the year, the difference representing wastage in the course of carrying on the business for that year.—In respect of these physical assets.

1592. Yes, in respect of these physical assets. Everybody seems to be agreed about that.—Yes, Sir, because you use the word "value".

1593. Value, yes. Now then if there has been a drop in purchasing power of the £ you say that that increases the value in terms of £s of a particular capital asset.—Subject to the measurement of the weight of tax.

1594. Yes, subject to that.—The relevant measurement of the two factors.

1595. It increases the value of that asset both at the beginning of the year and at the end of the year.—And the price.

1596. I use the word "value" in terms of £s.—May I suggest that that cannot be done correctly in a matter of this kind. The value remains approximately constant, while price is going to rack and ruin, which again is the difference between real and nominal.

1597. Let us try to talk the same language. I will use any term you like to mean whatever you wish it to mean. I was using the word "value" in terms of current £s.—Again therefore the value at the moment.

1598. The value at the moment in terms of current £s.—Yes.

1599. If the £ has remained stable all through the year in purchasing power and subject to any wastage by effluxion of time or other usage the value in terms of current £s of a particular asset will be the same at the end of the year as at the beginning.—That is so.

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SIR WILLIAM COATES, MR. A. H. ENNER AND
MR. W. MANNING DALCY

[Continued]

1600. And what you have to take care of is the depreciation that has taken place during the year.—Yes.

1601. And that you say should equally be measured in depreciated £?—Finally yes.

1602. If that has happened, of course, if you re-value the man's whole business in terms of depreciated £s, the whole business, capital assets and all other assets, he would have suffered no loss, would he, by reason of inflation?—Not unless you change the rates of depreciation.

1603. Is it right to say that where the £ depreciates and the purchasing power depreciates a man with physical assets in terms of current £s becomes richer?—Yes, any system should work both ways.

1604. In giving him credit for any depreciated £s at present in his account you think we ought to take account of the fact that the value has appreciated of the asset itself in terms of £s?—In times of inflation?

1605. If there is inflation if we give him a bigger charge against revenue for depreciation in terms of current £s you think we ought to offset that by taking into account the increase in value of the capital asset itself in terms of depreciated £s?—No, that account is confusing I think the real with the nominal.

1606. For example, some of us who were fortunate enough to buy cars just before the war found that the value of that car secondhand a few years ago was more than the price which was paid for it in 1939. If I were a business man on your footing I would be claiming a depreciation allowance on that car this year on that inflated value, would I not?—If you were using it for the purpose of the business, yes.

1607. And according to you I ought to claim depreciation allowance say of 10 per cent. not on the original cost but on this present inflated value?—I am assuming it was a business asset which you were using in your business and therefore contributed I would not say to your inflated earnings but to your earnings in inflated pounds.

1608. I am assuming it is a business asset otherwise it would not come into the picture at all. I am assuming it is a business asset and I am asked to deduct from my profits for the year a depreciation charge of 10 per cent. not on the cost which was, say, only £200 but on £1,200, the present day inflated value, that is what I am asked to charge, 10 per cent. of the £1,200.—I think in the case of the car it is drawing a distinction between what a man would pay for a new car and what he might have to pay for a secondhand car. One has a certain scarcity value and the other perhaps has more real value at the moment but at any rate cars are special cases which make it a rather difficult illustration.

1609. I know, I only used the car as a sort of firm illustration, but let us get away from complications and take any form of asset that would be worth today more than it originally cost because of the inflation of the £.—Yes, that little bit which is being exhausted, taken off the value by reason of the wear and tear during the year, is equivalent to my seed corn.

1610. Yes, and although he charges in his account as though he has lost 10 per cent. of the present inflated value you say we do not allow any credit to be taken for the increase in value of the car expressed in depreciated £s—I find that very difficult to follow.

1611. Perhaps I am not making it clear.—He has still got the car at the end of the year.

1612. It is on present day market value, say £1,200.—At the end of the year, let us say £1,000 at the beginning of the year.

1613. Yes.—I would attempt to arrive at the mean current value during the year and to allow him depreciation on that.

1614. On £1,100?—On £1,100, Sir.

1615. On the footing that he lost 10 per cent. of £1,100 that year?—Yes, and the car will be worn out in 10 years.

1616. But, in fact, the value of his car has gone up £200.—In terms of money, not in terms of the new car problem. It is just the case of the house all over again.

1617. It is no good our speaking of these things without some plan in our minds about it. Supposing you have a plant, and there are many cases of this to my own

knowledge, that will not require replacing for 15 years and in the meantime the plant is kept in a high state of repair all the cost of repairs being charged to revenue. What would you do with that by way of depreciation charge? Would you give the man an increased depreciation charge based upon replacement cost on present day figures?—During the 15 years, do you mean?

1618. Yes.—I think perhaps there are many methods of dealing with this particular problem. There is one that I myself as an individual favour but I cannot say that I am speaking for the Bankers in mentioning it, because we have not put to our colleagues in the Association the details or suggestions for remedies, and perhaps you would not think it proper for me to express any personal view. That is the difficulty I am in as representing the British Bankers' Association, Mr. Chairman. We did not put to our members suggestions, or requests that they should put forward suggestions, for solving these difficulties and working them out in detail.

1619. What is the man's difficulty in the instance I have just put, a man who has got his plant and it will not require renewing for 15 years; he is allowed to charge the actual cost of repairs during the whole of the life of that plant against his profits and as well he is treated as losing every year, say, 7 per cent. of the original cost of that plant. What is his complaint, if there is a complaint?—I think his complaint, of course, is a general complaint and is not founded on exceptional cases. There may be particular plants in which it is possible to be absolutely certain that nothing will require doing except maintenance and repairs.

1620. And renewals of small parts.—And renewals of small parts.

1621. All that is allowed as a deduction.—Nothing of a major nature and there will be no factors whatsoever of obsolescence, change of processes, but nevertheless he is allowed annually a sum in respect of wear and tear?

1622. Yes.—As I say I have not consulted our Association on this, but it does seem to me the problem is to take each of these annual amounts expressed first of all in the original £ and say the cost multiplied by the rate of percentage would be wear and tear, and then turn that amount for each particular year into the currency of the year by reference to some measurement of inflation in that year, attempting to make the measure of your inflation correspond as nearly as possible to the measure of inflation which has affected your profit.

1623. I think perhaps your answer amounts to this, that you treat everybody alike by a sort of arithmetical process with regard to their plant, do you? You say, whatever it cost you, if it cost you in terms of £s something less than it would cost you to-day if you were doing the same thing and paying depreciated £s, the amount that we consider you are losing each year is a percentage of that second amount.—I am afraid I have lost myself in your question again.

1624. Supposing a machine actually cost you in 1939 £1,000?—Yes.

1625. It is a kind of machine or plant like a brick kiln or something long lasting of that sort, and to-day it would cost you £3,000?—Yes.

1626. Assuming that there is a 5 per cent. depreciation allowance on brick kilns, we are going to treat you as losing every year 5 per cent. of £3,000 not 5 per cent. of £1,000, is that your proposition?—No, Sir, I think each year may have to be dealt with by itself as it comes. After all . . .

1627. I am talking about this year. We are looking only at this year, and the proposition is that the brick kiln which cost £1,000 in 1939 would cost £3,000 this year. Your brick kiln depreciates at the rate of 5 per cent. per annum. Now do you say we will treat you as losing 5 per cent. of £3,000 or 5 per cent. of £1,000?—Of the £3,000. That is the real value you have lost in wear and tear during the year in terms of to-day's prices in which you have earned the profits which are going to be taxed.

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SIR WILLIAM COATES, MR. A. H. ENSOR AND
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[Continued]

that he will have two. He will retain twice the amount of seed corn for that purpose.—Yes, if he is starting a new business in the sense that he has another field.

1563. It is an extension of his activities.—That is a new activity, a new business to some extent.

1564. The seed corn attributable to the second field you would treat as a profit, would you?—He has taken some of the proceeds of that first year to be the seed corn for the second. I say he has invested more capital because he now has two lots of seed corn instead of one.

1565. He has taken part of his profits of the first field and applied them as capital in the second business?—That is right.

1566. Would he be relieved from liability to tax on that profit he so applies?—I am not quite clear which profit you are talking of.

1567. The second lot of seed corn. Take it in your illustration, follow your first one, that seed corn is a base stock which goes all the way through his life, is it not? That is your view there?—Yes.

1568. I am taking the one where there is an extension, where he requires a bigger amount of corn to be kept in hand. Is that a profit on his first?—Take the first year, he retains his seed corn and he will pay tax on the balance which is the profit.

1569. Yes.—And he will pay it on corn less so much and then out of his taxed profit he will take the second batch for seed corn.

1570. That is what I thought.—Then the process starts again, but there is no essential difference between that and the first instance. He will have paid his tax, he will have invested his money like all of us do out of our taxed monies. We are not allowed to invest with untaxed.

1571. No, then is this really coming down to a suggestion that in all cases where stocks have to be maintained whether for manufacturing businesses or merchandising businesses there should always be a base stock?—Any addition to base stock may only be made out of taxed profits.

1572. That is the same thing.—I want to be quite clear with you, Mr. Chairman.

1573. Take the first year, you say, "I am going to elect to keep bigger base stock because I am extending my activities".—Yes.

1574. You agree that the first addition to that new base stock must come out of taxed profits?—Yes.

1575. So far that is agreed. Thereafter it should be, if he does not extend base stock, on the footing of twice the amount of seed corn that he first required?—I am sorry. . . .

1576. He started with one lot of seed corn.—I have said if he did not extend.

1577. If he did not extend after the first extension.—Yes.

1578. After the first extension if he remained constant for the remainder of his business life twice the amount of seed corn would become his base stock?—Yes.

1579. What would happen when he ceased to carry on business and sold his stock? Has all that profit, as it were, come into one year?—When he sells his stock?

1580. Yes.—Are you suggesting that at that time he has made a profit in respect of his stock?

1581. Yes.—He has in money terms, but not in real terms, as in the case of the house.

1582. When he ceases to carry on his business?—When he ceases to carry on his business.

1583. He will not want to buy any more stock, will he?—No, but in terms of reality it is only the same real value of purchasing power as it was in the beginning, so where is his profit?

1584. Is the suggestion that we ought to express a man's terms of profits in money first and then convert the money into some standard figure representing the purchasing power of the £ at some given date?—Yes, to endeavour to get at real values.

1585. What date would you choose as the date to fix the standard of the purchasing power of the £?—I think that carries me a long way from my capacity here today as a banker.

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[Continued]

1600. And what you have to take care of is the depreciation that has taken place during the year.—Yes.

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[Continued]

1629. The trouble is it is no good asking us to make a broad method of approach to this. Tell us what you think we ought to do. That is where we are trying to get assistance—I happen to be familiar, of course, with what Imperial Chemical Industries did in revaluing their assets, which you have no doubt heard about through the medium of the manufacturers' associations and so forth. There they endeavoured to have their plants revalued on the basis that we gave them the remaining life value in current monies and then provided depreciation on that, but that did not go perhaps the whole way because it did not take the replacement value to-day but it certainly went quite a definite way.

1630. May I just switch to one other point upon which I want to ask you something. You have mentioned it yourself and it comes under the head of paragraph 16.—Yes, Sir.

1631. What you say in the opening of that paragraph is:—

"The most serious effect of the overstatement of company profits in assessing liability to taxation is the restriction which it imposes on the ability of companies to accumulate sufficient resources for modernisation and expansion, or adequate financial reserves."

Inherent in that, Sir William, is the complaint I suppose that taxation is in any event too high?—Yes, I think that is inherent in that.

1632. And are you suggesting that the allowance of these depreciation allowances on the higher scale would wholly cure that?—I personally do not think it would.

1633. No, I thought you would say no. Is that not really the complaint of industry to-day, that the dormant partner, the State, the dormant partner who takes all the profits and shares in none of the losses, is taking too much out of industry in the form of tax?—Yes, Sir, as evidenced by our balance of payments, and the fact that somehow or other we cannot get our productivity to the right figure because we believe there is a repression of the real incentive through taxation.

1634. That is the last question I wanted to ask you about company taxation. Regarding your reference to incentives, I gather there is not a great deal of evidence about this, that this high taxation does restrict enterprise?—No, Sir, I do not think there is.

1635. It is the sort of thing where very often it really depends on the individual's own personal circumstances, do you not think?—Yes, in the second part of the questionaire which we shall consider presently we hope perhaps to provide you with some answers we are talking about there. I see no reason why I should not say that bankers do come across cases within their knowledge where Mr. A. works regularly in trade X, but if he is doing any overtime he selects some other occupation in which to do it in the expectation that while his first earnings on the weekly basis are in the schedule his odd ones do not...

1636. You mean that if there are, say, two farmers employing farm labourers, the farm labourers of Mr. A. will not work overtime with Mr. A. but will go and work in the evening with Mr. B. and vice versa, is that it?—That is right.

1637. That is just pure evasion of tax liability, is it not?—Yes, it is; but in a sense so is any refusal of an ordinary worker to work overtime at all.

1638. That may be avoidance but not evasion.—These are matters of language, they yield the same coin on the counter. If it is true technically they are...

1639. If labourer X works for Mr. A. for pay and works for Mr. B. for pay in the evenings technically he is liable to tax on the remuneration he receives from both A. and B.—It does not require me to tell you in the legal profession what practical evidence you need to prove your case in law before he has evaded.

1640. I say he is liable to tax on all his remuneration earned like that, but he does not pay tax on the amount he earns from Mr. B. because he is not on Mr. B.'s regular payroll.—That is so. He will enter it on his personal return if he is asked for one, but it may be that he is not asked for one. It may be that his personal allowance is presumed to be the same as for the preceding year, and in that case there is no technical evasion.

1641. No, there is no technical evasion if you do not make a return and you are not asked to make one.—An evasion which is not technical is only avoidance.

1642. I have read what you said about the effect of risk bearing. Do you think that really is a serious matter?—You are referring to paragraph...

1643. Paragraph 22.—Yes, we think that is a serious matter.

1644. And the banks have definite evidence in their possession that would lead them to suppose that many men refrain from embarking on trading or professional adventures because of the tax results?—We believe we see evidence of a reduction in the supply of this capital.

1645. It would not be because they have not the capital to invest, would it?—No, it very often is that, of course, but we think also the other factor may enter into it, that they have to bear all the loss but only receive a portion of the profits.

1646. It is right, Sir William, is it not, that owing to the high rate of taxation on personal incomes individuals have not the money to spare to invest to-day that they had in the past?—No, that is quite true.

1647. Is that a contributory factor to the absence of investment on risk capital?—I would say undoubtedly yes. In the second sentence we say:—

"It is considered that the weight and incidence of taxation place insuperable obstacles in the way of the accumulation of capital for the financing of new enterprises and expansion."

1648. That is what I mean. We must not put it all down to the fact that taxation on the man who is going to carry on the projected business prevents him from carrying on that business, it is not entirely that—I quite agree. I should say there is the potential shareholder who is also very much afraid.

1649. It is the other aspect of it, you say, that he is not left enough money for investment?—Yes.

1650. In other words the rate of taxation is too high again?—The rate of taxation is too high.

1651. Mr. Millard Tucker: Thank you, Sir William. Now my colleagues want to ask a few questions and I might be convenient if we started with Mr. Keldor.

1652. Mr. Keldor: I want to ask a few questions arising out of this paper. First of all you produced some figures at the beginning concerning the movement of liquid assets of companies between 1946 and 1950.—Yes, or 1949.

1653. Would you say 1946 is a very significant date to choose from this point of view?—It was of course the first post-war year and we chose that because clearly any earlier year would produce very artificial results by reason of the war circumstances, and the war taxation and so forth. We would have liked to have taken 1946 to 1950, or 1951 at any rate, but we were doing the best we could with the bricks we seemed to have available. We certainly would not claim they were entirely satisfactory.

1654. You would agree that during the war firms, except those working on war orders, of course, would not be in a position actually to re-invest their reserves and that stocks on the whole would be running down as compared with the normal?—Stocks would be?

1655. Run down during the war.—To some extent, quite definitely.

1656. You would expect over the period of the war as a whole the balance sheets of companies would show a movement from real assets to liquid assets.—Yes, that would be a tendency that way quite definitely.

1657. And a reversal after the war from liquid assets to real assets as shown by your figures. That may not be indicative of an abnormal situation; it may merely imply that as normal conditions are re-established the firms are able to re-equip themselves again and to build up their stocks which have run down during the war so that liquid position would naturally deteriorate.—There would be changes of that nature. I think Mr. Manning Dacey who scrutinises figures in more detail than I do would agree with that.—Mr. Manning Dacey: One would expect a switch between stock and more liquid assets.

1658. You would expect the movement one way during the war and a reverse movement after the war.—Yes, we have taken it for granted that in 1946 stocks were abnormally low.

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1659. My point is if you had available some pre-war year, 1938 for example, which I take at you just have not got the figures for, it may even be the case that firms are more liquid now than they were before the war.—We have no evidence of that.

1660. We have no evidence that they are less liquid than they were before the war.—No.

1661. Therefore I suggest movements since 1946 are not specially indicative of anything because as firms have opportunities to rebuild stocks and have opportunities to renew their capital assets it would be normal that they should use their cash for that purpose. It would be a wrong thing if they did not. That is one point. The other point, Sir William, if I may return to the general issues that we have under discussion, I suppose it would be correct to sum up your position by saying profits should be calculated after full provision is made to maintain real capital intact?—Yes.

1662. In other words, any profits that arise if provision is merely made to maintain money capital intact are excessive and should not be taxed. You heard the Chairman give the example of a man buying a house for £1,000, selling it for £5,000, but since that is the value now of a house of that size there is no profit. Supposing a man had borrowed £1,000 in order to buy a house; actually it would have been difficult for him to take out a mortgage for the whole of the £1,000, but he might have taken one out for 80 per cent. of it. Say he had borrowed £800 in 1914, and bought a house for £1,000 and he sold his house for £5,000, and out of the proceeds he has repaid the mortgage of £800, would you then say there was no real profit there?—Sir William Coates: There is a profit to the man and an equivalent loss to the mortgagee.

1663. You would agree?—Yes, but there is no real total addition of profit.

1664. Would you say that the present system of taxation discriminates unfairly against the business man in comparison with other classes of the community owing to the fall in the value of the £?—I do not think I would necessarily say that. I take the view the business man is especially important because it is, I think, rather more his function immediately than any others to maintain the earning power of the United Kingdom in this competitive world, and that anything which interferes with his capacity to do so, or even with his, I hope, general inclination to increase productivity is to be deplored.

1665. But there are two issues here, firstly the general question which the Chairman mentioned to you, that taxation is too high. If taxation is high, the British business man may be put at a disadvantage as compared with business men of other countries where taxation is not so high. That is one issue.—Yes.

1666. There is the other issue, whether the result of the inflation that has occurred in this country is such as to put the business man at a special disadvantage. That is really the issue with which we are concerned, the second one—I do not put it myself on those grounds. I put it on the grounds that he is being deprived of what, I think myself, the law originally intended to give him.

1667. You would agree that so far the law of this country has nowhere recognised the existence of depreciation in the value of money?—This particular factor, if I recollect rightly, was recognised in 1878 in the Act which gives you a wear and tear allowance, and that was incorporated in the Act of 1918; there the allowance was to be such allowance as the Commissioners having jurisdiction thought fair and reasonable in respect of the diminution in the value by reason of wear and tear. If the Legislature really meant what it wrote at that time, it was value.

1668. Money value or real value?—Value by itself, and you would agree as an economist that value by itself is its ratio in exchange with other articles and has nothing to do with money necessarily. Had that been continued then the value would have had to be translated into the money of to-day as the profits were.

1669. But is there any basic difference between recognising the depreciation of the £ for the purposes of calculating depreciation of assets and recognising the depreciation of the £ in all other things, from the point of view of contracts? I do not see any difference. Is there

any difference by which you can say "We do not wish in general to recognise the depreciation of the £ and to re-value contracts. We do wish it to be recognised in the one special respect that reduces the tax liability of business men, but not in the respects in which it increases their general liabilities as against their creditors"?—This depreciation of the £, not in the particular contract of any particular person, usually works two ways. It may have a counter-balancing point, but in this matter of wear and tear the gain is to the revenue, the tax is taken away, but most important of all from the business point of view is that the continuous earning power of the nation is being slowly, I think, damaged by this denial of what in our view the Act originally provided.

1670. Would there not be exactly the same case for saying the real value of personal allowances in income tax have diminished as the result of the rise in prices?—Yes.

1671. And the tax cuts into that essential tax free medium the Legislature intended to provide?—We shall be saying that when we come to your second section.

1672. Apart from these effects, if I may come back to the economic effects. Would you say now after the many years of inflation that we have had since the war, industry finds it difficult to replace capital in any real sense? The point I would like to ask you about is this: from the one side inflation causes an increase in the real burden of taxation as compared to what it would have been if there had been no inflation because of the calculation of depreciation. Is there not on the other side not one but many offsetting factors which put industry in a financially stronger position than it would have been if there had been no inflation. If you strike a balance between the positive and negative factors...—Would you particularise those many factors?

1673. A time of inflation is generally known to be a time of high profits—in terms of money, but if you get no more apples for your money, are you any better off? If the revenue by the provisions of the tax takes away a large percentage of your money, then the apples diminish as well.

1674. Would you say the undistributed profits of industry had risen since the war less by reason of the rising prices or more?—I should have to look at the statistics that were available before I could answer that.

1675. Would you accept this as evidence if you were to find that they had risen quite a lot?—I am sure they had risen quite a lot.

1676. Supposing you were to find they had risen much more than the rise in prices, would you accept that as evidence that the financial position of industry was not too bad?—What is happening in that respect, if you make provision for stock replacement too, which the White Paper does...?

1677. Yes.—Did we not mention that the figures were close together? You will see from paragraph 14, in the five years, 1946 to 1950 according to the National Income White Paper* sums totalling 6652 million were required for the purpose of replacing stocks. I have the White Paper here. In 1951, the Economic Survey† estimates, £700 million will be required to finance stock replacement but the total of undistributed profits is placed at only £690 million and you have not dealt with the wear and tear so the evidence seems to be all the other way.

1678. Mr. Millard Tacker: What page are you looking at?—Paragraph 14 of our memorandum and the Economic Survey for 1951,† page 44.

1679. Mr. Kaldor: You mention a figure of £700 million here as a provisional estimate for 1951.—Yes.

1680. And a figure of £690 million, but that does not relate to 1951, it relates to 1950.—Mr. Manning Dacey points out that just above you have a figure for 1951 of £780 million as against £700 million required for replacement of stock at higher prices and he tells me by reason of the budget that £780 million was reduced to £690 million.

* Cmd. 8203, National Income and Expenditure 1946 to 1950.
† Cmd. 8195, Economic Survey 1951.

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1681. If you look at what is actually allowed for depreciation, or was allowed until recently, together with initial allowances you would find that the amounts so allowed have risen by about two and a half times since the war—Allowed for income tax purposes?

1682. Yes.—If you turn to Table 26 giving the 1948-1949 figures in the Report of the Inland Revenue Commissioners* you will find depreciation allowances are £330 millions. If on the other hand you contrast that with the National Income White Paper in Table 29 on page 42, item 8, you will find in the year 1948 they are shown as £750 millions so the official publication shows a deficiency after you are equating the other two matters of something like £420 millions.

1683. Table 29 on page 42 of the National Income White Paper under the heading "Provision for depreciation by enterprises" gives the figure of £1,022 millions for 1950?—If you look at the Inland Revenue White Paper, for 1948 you will find, if I read it rightly, the allowance was £330 millions, yet when you turn to the White Paper you have just quoted for the same year 1948 the figure is £750 millions. I think the White Paper recognised the official allowance was not right; I do not mean it was incorrect but it was not adequate.

1684. The official figures may be right or they may be wrong?—They are both right I assume.

1685. They are both right?—Yes, one is officially allowed, the other is officially required. That is how I interpret it.

1686. I do not wish to hold up the meeting now by going through this point but I do suggest to you if you take the figure allowed for depreciation, add to it initial allowances, add to it the undistributed profits of enterprise and compare these items for 1938 and 1950 you will find an increase in the money side that far exceeds any possible allowance for the rise in prices. That is true even if you make special allowances for the increased cost of replacement of stocks, at any rate up to 1950.—I am sure one has to take account of the expansion of enterprise. All there are two and a half millions more, if not three millions more people engaged in earning their living today than there were in 1938. Is no allowance to be made for that in your figures? On the face of it, the figures for 1948 do not in my view support your proposition.

1687. Your point is that business at the moment is not setting aside enough after taxation?—It is setting aside, I think, generally more than is allowed for income tax purposes, but I would still concur in the view that it is not setting aside enough. We need other factors too to meet the increase in productive capacity; that means coal, steel and real things, you will not get all the way merely by providing the money, but you take one step at any rate.

1688. May I just ask one last question. If a proposal for this special concession about replacement costs were linked with a proposal for re-valuing debts, debenture interest and other obligations in accordance with the rise in prices, would you say from a business point of view it would still be an advantage to adopt a principle of re-valuation or re-valorisation?—That again, I am afraid, is a question on which I would find it difficult to speak as a representative of the bankers. We did not put that hypothetical question to them. It was not indicated by the questionnaire, but I think we said something on the subject in paragraph 12:

"We would submit that the position of a trader is fundamentally different from that of a person who has chosen to invest his capital in claims to money, thereby accepting the risk of a depreciation in the value of money."

That is our standard. There is a different element involved in investing money only in gilt edged or fixed interest securities on the one hand, and entering into the risks of enterprise. The one, while it is necessary no doubt, does not facilitate the growth of industry and productivity in any real sense like the second one, not in the same measure as the second does, and the fixed interest investor chooses the path of security, as many factors of security as he can secure, but I think having made that choice he should abide by it.

* Cmd. 5103, 93rd Report of the Commissioners of Inland Revenue.

1689. Your point is that those who put their money in the bank or put their money in Government securities or in industrial debentures do so in full knowledge of a risk of depreciation in money and therefore it is a risk they ought to bear,—I think that is a risk which they have weighed and accepted.

1690. Could you not equally say that those who put their money in ordinary shares or in real capital accept the risk of an appreciation in the value of money. I know money lately has been depreciating rather than appreciating.—Not as a necessary expense of the business. Whenever a manufacturer sells he is selling an appropriate tiny section of his plant and machinery. Unless it is to come to an end he must have it back as an expense, an item which represents something he has sold to the buyer.

1691. He may get it back out of taxed profits just as much as out of tax free depreciation. Provided he puts aside enough to replace it or provided he can borrow money for it, if it appears profitable it will be replaced.—This provision for wear and tear was originally made in 1878, the beginning of a period of slowly falling prices, or after they had started, from 1873 to 1893, so that these problems did not positively enter their heads; nevertheless they did provide that the expense should be a deduction in respect of value lost, not money. Maybe they were conscious that prices were falling and this wear and tear allowance instead of rising each year from inflation should diminish each year because of deflation that was going on. I was not on the scene at that time.

1692. Mr. Hicks: Before stepping into the ring, may I be allowed to ask that the Secretary should enlighten the Commission at some time about the discrepancy mentioned by Sir William a minute or two ago, in order that the matter may be looked into?

1693. Might I begin by going back to the figures in paragraph 6 of the memorandum? You have told us that it was not possible to go back further than 1946 but I think it was really implied that 1946 must be regarded as a very abnormal year. That would surely not be denied.—Yes, the first year after the war.

1694. I was really wondering whether you or your colleagues would go so far as to hazard an impression whether in the light of their experience of banking conditions and the rest of it, they would be inclined to say whether the general situation disclosed in column (i) is really any less abnormal than that disclosed in column (ii), I should have thought it was the other way round. Column (ii) was nearer to what one might expect in the normal year than column (i).—Unfortunately we have no seasonal or other statistics giving us any broad picture of an analysis of this kind in a normal year, say in 1925, not 1938 that was not normal, or 1935. Mr. Manning Dacey can give you the figure of some analyses of these two columns in terms of the position of firms having overdrafts and those not having overdrafts.—Mr. Manning Dacey: We did put these figures in with some reservation. We recognised the sample was small. We pointed out the abnormal features of 1946 and we pointed out that the bank would have the balance sheet of the borrowing customer rather than the non-borrowing customer. I have some supplementary figures which show the broad position; in the earlier year about one-half of the companies in this sample had overdrafts and in the latter year rather less than three-quarters.

1695. Then for my next question might I go back to the White Paper which you have been referring to? I have been looking at it to see whether one could gain some kind of impression of the proportion of national resources which are being used for consumption purposes, Government purposes and for the maintenance and increase of capital respectively. There are various ways in which one can get that division. One way which is as satisfactory as any other is I think in Table 33 where you see sales divided up into sales to persons, public authorities and capital accounts; sales to capital accounts being effectively, I think it is right, really replacement of capital assets and new capital assets produced. If you divide those up as a proportion of the total, I may be wrong in detail about the figures, but I think I am right in saying in 1938 the proportions come out at about 73 on

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consumption, 12 on public expenditure, 15 on capital replacement and reconstruction, whereas in 1949 I get 47, 15 and 18. 1950 is very similar, slightly more to consumption. Generally speaking, whichever way you work it out, I do not think there can be any question, taking the thing gross, on replacement and reconstruction together there has been a swing over of the national resources from consumption towards both Government and private investment since before the war. Therefore although it is very probable in any reasonable sense we were investing too little before the war and though the needs for investment are undoubtedly very great now, it does remain the case we are investing rather a lot in real terms.—*Sir William Coates*: That is total investment.

1696. That is total investment.—*Taking everything*.

1697. The whole lot altogether including both replacement and interest.—*Industry is concealed in it, but industry is a comparatively small proportion of the total*.

1698. It is a largish proportion of the total.—*I do not know what it is today on the Economic Survey, I think it used to be roughly about one-seventh. Perhaps they do not even give it today. The analysis of it is what we want. It gives the national investment and so on but I do not think the Economic Survey today publishes the analysis of that expenditure*.

1699. I do not think the question I am leading up to depends on a detailed figure. It is rather this. If, as a result of any of the sort of concessions you are suggesting, more money is left with business and less is taken by the Government, that must mean either that the reserves of business which it does not spend are increased, or that the amount of expenditure on capital equipment is increased. From the point of view of the effects on the economic system which of those two things is it you want to happen? Is it to spend more on your equipment allowing for the fact that will be inflation, or do you want them to have larger reserves trusting that they will not spend them?—*I think we want them to have larger equipment from the point of view of productivity*.

1700. It will be inflationary if they try to do too much?—*It depends what other measures you take. There are other methods of countering that. You must not necessarily assume they all go one way. The urgent necessity I should have thought for this country to expand its productivity stands out so prominently whatever economic figures you look at, as to be one of our most urgent problems*.

1701. Then the implications of the proposal are effectively that taxation on business should be reduced in order that business may expand its equipment, it being recognised that must mean either somebody has to consume less, or the Government has to spend less either on its ordinary Government services or on its own capital projects?—*Yes, we think the daily bread and butter comes first before going to the cinema, you might say, in broad terms. It is difficult to say. The reserves would probably be spent on capital equipment with extensions of some kind or other, but at the moment they should be increased by reducing the taxation because of what we feel is the injustice of it and the depreciation of something which industry previously had*.

1702. May I now go to paragraph 9 where you say:

"Up to the present the financial position of companies as a whole may not show such acute stringency as is sometimes supposed to prevail, but the danger of serious difficulties is clearly suggested if the inflation of recent years should continue or, alternatively, in the event of any considerable trade recession."

It is a little curious at first sight why there should be difficulties if things go either way. Would you be prepared to enlarge upon that?—*Mr. Manning Dacey*: I think we had in mind that if both inflation and higher taxation continue, this would accentuate the disparity we thought we could detect in the figures between the growth of the capital resources of the private companies and their turnover. If one looks at the position, the increase in the capital of these companies, which are private ones and are not in a position to have access to the capital market, has been comparatively small and as their turnover in money terms has grown, so we feel

the disproportion has grown there. Similarly, would you not agree that industry having got into that position in which capital resources were strained in relation to its turnover, if you had a very serious recession, there would be very serious difficulties?

1703. I see the difficulties you have in mind are essentially of quite a different character. If the inflation continues the difficulty is that industry will not be able to invest. That is not so much the inflation continuing but the amount of Government expenditure continuing, the inflation may continue if Government expenditure is reduced.—*Sir William Coates*: It might, but it is not so likely.

1704. Whereas in the case of the trade recession the danger is that business expenditure might contract more rapidly than it would otherwise.—*Contract at once I think*.—*Mr. Manning Dacey*: The value of stocks will fall rapidly and if the reserves are inadequate one might expect bankruptcies.

1705. If you go over on to a replacement cost basis and the value of stocks starts falling rapidly it is going to go the wrong way.—*Sir William Coates*: Yes.

1706. Might I go on to the next sentence where you say:

"In either of these contingencies, it seems probable that large sections of industry would be able to maintain their activities only by looking to the banks for support on a scale which, in many instances, might not be justified in relation to the trader's own capital resources."

That sentence seems to me to have certain implications in regard to banking policy on which one would particularly like to hear you enlarge. As has been pointed out previously it does appear from your cable that the firms are in fact relying on bank overdrafts to an increasing extent, though it has also been observed in the previous discussion that that is perhaps not so surprising when current assets and stock and so on have been increasing in value so much. In the light of that I should like to hear that sentence enlarged on.—*In the one case of course, the present position would get worse and the weakness through relying on bank support would be greater if the inflation continues, but in a trade recession than you may rapidly run into trade loss and the losses on your profit and loss account can so eat into your capital account and provide much more doubtful security for whatever advances you have got. You might get pressure to push a trade recession at a more rapid rate than in the absence of those losses*.

1707. Can I ask a further question arising out of that? This question of replacement cost and estimating depreciation allowances in real terms is important from the point of view of tax which immediately concerns us, but the other thing which concerns us at one remove, is the general profitability of the business. Is it the case that banks find when considering the profitability of business at present that they do have to pay a great deal of attention to the question, as one might say, of the time structure of a firm's capital assets in order to see whether its apparent profitability as indicated purely in money terms is different from its real profitability, and what do they pay attention to in that connection?—*Mr. Enner*: Normally it is not the banks' habit to lend against capital assets but against liquid assets. On the other hand, being prudent bankers we would look at the capital structure of the company in the way of equipment and machinery, not relying on that however unduly as a security for an advance.

1708. It does enter into it?—*It would enter into it. We should not make a particularly strong point about it though we should not avoid it entirely*.

1709. May I go on to paragraph 16? You are speaking about financial institutions and you say:—

"The public interest would obviously suffer if the weight of taxation should make it difficult to maintain reserves of sufficient strength."

I think that applies to financial institutions more particularly.—*Sir William Coates*: Yes.

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1710. Is it supposed that any concession that could be asked for along these lines of adjusting for the depreciation of physical capital could make any difference to financial institutions?—Not in respect of the physical capital, that is not analogous at all, but I think it is rather the general principle of taxation being too high and therefore the reserves being too low that we had in mind here. We were not specifically asking for concessions in this but if it should be found possible by you and other authorities concerned at a later date to give some relief in respect of reserves the position of financial institutions which must maintain fairly substantial reserves should be borne in mind. We do not put it higher than that.

1711. The problem is a difficult one which cuts both ways. From the point of view of proper protection against a slump you want to ensure that financial institutions have large and adequate reserves?—That is so.

1712. From the point of view of controlling inflation on the other hand it is important that they should not have excessive reserves. I am thinking not only of banks but of financial institutions generally.—They may have an element of inflation, but they also have an element in them of reality. Though there may be more inflation there would be also more reality. That which is left after inflation has been expressed, pressed out, is what you are saying would count. I still think that leaves the proposition that reserves should be adequate in relation to the risks being carried.

1713. Is it maintained that the weight of taxation on banks and other financial institutions such as insurance companies is such that in itself it makes it difficult for them?—We are not putting forward that proposition. What we say is if there are any concessions they should not be related exclusively to the physical capital because financial institutions are important in our national trade.

1714. Mr. Kaldor: You said that the interesting thing in these figures was the fact that the turnover had increased in relation to capital and reserves.—Mr. Manning Dacey: But more in relation to capital. You will see that in these three years these companies increased their capital by 17 per cent. though they added 75 per cent. to their reserves. It seemed to us significant that capital seemed to be lagging very much behind all the other elements in their business.

1715. What is the difference between increasing their capital and increasing their reserves? They increase their capital by making a bonus issue. There is no difference from the point of view of whether their capital or their reserves are increased.—Surely the growth of capital is related to the bank overdraft. Had they been able to obtain more capital from outside the business they would not have had to borrow so much from the banks.

1716. I thought your point was turnover had increased faster than the capital and the reserves taken together, in other words, that the capital employed in the business had risen less than the turnover?—Yes, Ratio XI in paragraph 6 does show a certain rise there.

1717. The point I really want to put is this; to what extent do you think this is really a reflection of the fact that fixed assets have not been re-valued in the balance sheet? If fixed assets were re-valued in terms of current values, new reserves naturally would have to be created, reserves out of the re-valuation of assets which I take it must have happened in the case of L.C.I.—Sir William Coates: It is a factor. One of the assets in the balance sheet is on an incorrect basis, I agree.

1718. If you look at the figures, would it be possible this whole appearance would be changed if you re-valued assets in terms of current values?—Yes, I quite agree. That is the worst of having things in two different measures.

1719. Mr. Crick: There are one or two things arising from paragraph 4 which I should like to take the opportunity of putting to Sir William. I am quoting here and asking you a question: why was it felt that it is the small and medium sized private companies which are likely to be most adversely affected by taxation? Just why did you feel that?—One of the things we mainly had in mind was the difficulty of access to the new issue market for private businesses and companies in which the raising of capital is often a matter of the greatest difficulty.

1720. You would regard that factor as being more important perhaps than the tax factor?—It is very difficult to make comparisons of that nature, very difficult indeed.

1721. Then in your next paragraph you suggest that the pressure of taxation on unincorporated businesses is greater. That rather suggests you have three degrees of adverse effects to consider. The least adversely affected are the large well established companies, next come the small and medium sized private companies and most unfortunate of all are the unincorporated businesses. Would that be a correct statement of your opinion of degrees?—I think that was the view the Bankers tended to generally.

1722. You are having in mind all the time these other factors, one of which you have just mentioned. Would you feel, if you could isolate the tax factor, that would be the order of seriousness of the effects of taxation?—When you speak of the tax factor, you mean the weight of the tax. It depends how much you amended the tax.

1723. You told me the difficulty with the small medium sized private companies is the difficulty of raising capital. If one takes away that sort of factor which is not a tax factor, then what I am trying to get at is the precise incidence of the ill effects of the tax factor on the situation, and I am asking you whether it would be right then to say the least affected are the big prosperous companies, next the smaller companies and worst of all the unincorporated businesses?—I do not like to commit myself to an opinion on that I am afraid. We have the other factor of surtax with the unincorporated business so there is a heavy factor in that.

1724. The final issue I am coming to, and I am wondering if you can throw light on this question, is whether the more serious drain set up by taxation under the present system arises on the side of self finance of business undertakings or on the side of the provision of new private capital for equity investment?—They are both factors. It is very difficult to find means of measuring their comparative effect. The only thing I can say is that self finance, as the Committee on National Debt and Taxation found in 1925, is in many respects the most satisfactory form of providing additional capital because it is applied at the spot where it is most useful and applied at least expense.

1725. So you would rather welcome what I might call the by-product of present taxation, namely that a much higher proportion of total new capital is found by way of self finance. May I switch to a question on paragraph 2. I confess I was not very clear as to the relevance to your subject of the statistics mentioned in paragraph 2, but perhaps you could throw light on that. If we turn back to the Table I in the annex I want to refer you to column 5. You make the point there that what you might call the proportion between liquid money and national income was very much higher in 1945 than in 1938, and indeed was still higher in 1946 and 1947. It then falls away as you know but in 1950 it remains very substantially higher than in 1938. Now you suggest that for some reason or other that figure of 60.7 represented stringency as compared with the figure of 51.8 in 1938. Were there some circumstances to account for the difference? You are still more liquid on those figures than you were in 1938?—Table II does show there is a shift between personal and other deposits.—Mr. Manning Dacey: The Commission might like to have the later figure, the figure for June 1951 is now available. Would you like the figures to add to that? June 1951 gross deposits £6,167 million and then gross deposits less advances £4,285 million, personal £1,676 million, other accounts £2,609 million.

1726. So it has moved a little in the same direction?—Yes. In the year to June 1951 the personal fell by £17 million but the other accounts fell by £50 million and the ratio of net personal accounts has further risen to 39.1, that is against 38.9 in June 1950.

1727. Mr. Kaldor: Have you the figure for 1938?—No, returns were not collected until the National Income White Paper began.

1728. Mr. Crick: So the reconciliation is to be found in Table II. In other words, you are saying persons are more liquid and businesses are less liquid than in 1938?—We cannot make a comparison with 1938. We are

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SIR WILLIAM COATES, MR. A. H. ENNER AND
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[Continued]

merely saying that at any rate over the period covered by these returns there has been a shift in deposits in favour of persons.

1729. Your Table II figures go from 1942 so the presumption is the trend should be carried back to 1938, I suppose. You have a position in which there is an overall increase in liquidity compared with 1938 on Table I. You also suggest that industry has been becoming more illiquid at any rate in the post-war period. Does not that suggest there is some barrier to the transference of risk bearing between private persons and business undertakings?—Sir William Coates: To some extent it is the risk bearing on new issues.

1730. So you have another factor that tends to reduce the tax element in this problem?—Does it? The tax element enters into this problem.—Mr. Manning Dacey: May I go back and remind you, I expect everybody realises it, that non-personal accounts are not wholly business accounts. There are various categories, including presumably deposits owned abroad, so that the figures we give for "other" deposits are not necessarily those for domestic industry.

1731. Will you kindly divert yourself, Sir William, of your capacity as banker and speak as an economist with very wide experience and observation of industry and finance. You will have noted, as everyone has in these later years, that taxation has come to be used as an instrument of economic policy, which I suppose it never was until the time of the war, as distinct from a mere method of raising enough revenue to cover a certain amount of Government expenditure?—Sir William Coates: I think that is so.

1732. Is that a development you regard as something to be welcomed or something that you deplore as an economist?—Welcomed in principle I think, deplored in its application.

1733. Would you go a little further?—No, I think I have gone far enough. I have already denied publicly that I am an economist.

1734. Mr. Millard Tucker: Sir William, have you also been a diplomat?

1735. Mr. Carrington: Just one or two questions on this very difficult problem of value as distinct from monetary price. Taking first of all the question of profits on stock inflation, the profits that arise when the price of stocks is inflated, would you regard the method which is available to the taxpayers in the U.S.A. as something which would be helpful if made available here?—I have only read a little about the American method, not sufficient to convince me at any rate that I truly understood how it works.

1736. It is essentially a base stock method with certain refinements for what they call involuntary liquidation.—It is more than F.I.F.O.?

1737. It is very much different from F.I.F.O., that is the one to which you objected. It is a combination of L.I.F.O. and base stock.—There were instances in the first World War and the first excess profits duty which had some concessions by arrangement with the Revenue in regard to base stock, that is to say in some non-ferrous metal industries it was not governed by the movements in the market price. To have levied a tax on the inflationary movement in the value of it would have been too wicked for words.

1738. In the cotton trade there was for many years a practice of working on base stocks and then I think you will find on enquiry a substantial section of the industry went to the Inland Revenue after the 1914-18 war and asked to be taken off?—Asked to revert to the old method?

1739. They asked for the old method back again.—They were not properly advised by the economists.

1740. That is a point I want to put to you. Assuming one adopted something on those lines of L.I.F.O. or base stock, something that was aimed at taking out of the tax gatherer's clutches the inflationary profit, what would your view be as to the method of tax computation and accounting when commodity prices fall either generally or in a particular industry? In other words, should the taxpayer be entitled to take stock at the old original cost, base stock figure and then if prices drop below that

should he be entitled to an allowance for the further fall of market value below his base, or would you say "I will hold to my principle of value and give him no allowance" though in terms of money his stock value has dropped?—I should hold by the terms in value, I should say it is neutralising the effect on stock if you can get to the position of agreeing what I call the volume of that stock. I think the base stock in principle is correct. It is like something you have in your hands and if you can ignore the perishable nature of things you turn it over and over and it remains in effect the same fundamental economic factor.

1741. In other words you look on stock in a continuing business rather as a fixed asset, something you must hold in order to make a profit?—Yes.

1742. You would not take any notice of a fall in the monetary value?—No.

1743. As a banker would you subscribe to the view that a balance sheet presented to you in those circumstances would be a true and fair one?—You may read many accounts today which contain those words where you might have grave doubts of the economic, at any rate, correctness of that statement.

1744. I am asking you to postulate a fall in prices.—What bankers would do in new circumstances is again a hypothetical question.

1745. I do not agree that it is.—Personally in so far as I am a banker which is to a very limited extent I would say yes. Given that that was the official policy and that all balance sheets were being drawn up on those lines then I think the banker would rapidly adjust his judgment accordingly.

1746. You are saying it is hypothetical. I suggest it is not. We have had the experience of wool prices over the last 18 months and they have not been on the up-grade but on the downward run.—Yes, to some extent.

1747. To a rather large extent I suggest. Does this theory of yours apply irrespective of whether the stocks have been financed out of the trader's own resources or out of money borrowed from the bank?—You mean in regard to the stock question.

1748. Yes, looking at value in terms of your conception of value and not monetary price.—Yes, I think I would say yes to that.

1749. Even though if the price drops and the commodity is sold at a lower monetary figure than the individual paid for it in terms of money the banker would want re-paying in full in the 2½ current at the time of re-payment?—Yes, you are dealing with two different sets of circumstances.

1750. The relationship between creditor and borrower and the relationship between trader and tax gatherer, you see a difference between the two.—Inflation is a factor on the one hand which you cannot ignore. A banker is a dealer in debts and that is the footing upon which his credit rests. When it comes to the tax gatherer and stocks, then you have a different set of circumstances, a wider set of circumstances I would submit to you.

1751. This point does rather worry me, whether we can take one basis for accounting as between the tax gatherer and the trader and another basis of accounting as between the trader and his creditors. That is a point upon which I should like a little elaboration if I can trouble you.—It is one of those difficulties in which I am faced with the conclusion that both of them are true.

1752. Which basis of accounting would you use when presenting accounts to the shareholders?—I think you would have to present accounts to shareholders in your own inflated money. You might have to indicate by notes on your accounts what you have done, as is often the case today, but the question of correcting what I think is an injustice in regard to taxation can be set out and explained, and no doubt would all be explained, argued and discussed before it came into force so that people would know what had happened. It is more or less impossible to inform the stock holder today of all the details of how you calculate profits tax or the balancing charges and that sort of thing. You do not find it necessary to do so. There may be some relief that is given

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[Continued]

in this respect from the national aspect and justifiably so, but do you need to put it all out in the detailed calculations of the accounts?

1753. If you refer to the American law on the subject and the American regulations I think you will find that if a taxpayer chooses to work on this L.F.O. or base stock method of accounting for tax purposes, he is required to adopt the same accounting method in accounts to shareholders and in any accounts submitted for the purpose of claiming credit, and I was wondering what your view would be on whether this Commission, in the event of it accepting your proposition in principle, would be justified in laying down the same requirement or suggesting that the same requirement be laid down here as in the United States?—I have not had an opportunity of pondering on this. It is another question not included in your questionnaire, but looking at it broadly, I should be inclined to agree the American rule was correct when you put it to me like that.

1754. I will not trouble you further on this, but might I ask when the Association is putting in the replies under head B that they might arrange for someone to look at the American system and let us know whether they think it appropriate for adoption here, and secondly, what their views are one way or the other on the point as to making it obligatory for accounting purposes *vis-à-vis* credit and shareholders if it is permitted for tax?—We shall be very glad to do so. I am conscious in this for exchange of having contradicted myself, but when I see the record and read your questions in a fuller sense than I understood them, I shall be able to think it over and reply at leisure.

1755. *Mr. Carrington*: Would your colleagues consider it and put a note in under Head B. I think we shall find it helpful. I do not think I have any more questions.

Mr. Millard Tucker: Thank you, Sir William, Mr. Ensor and Mr. Manning Dacey for coming.

The witnesses withdrew.

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MINUTES OF EVIDENCE **7**
TAKEN BEFORE THE
**ROYAL COMMISSION ON
THE TAXATION OF
PROFITS AND INCOME**



SEVENTH DAY
Friday, 23rd November, 1951

WITNESS

MR. H. N. HUNT, C.B.E., M.C.

Questions 1756-2017



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1952

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TERMS OF REFERENCE

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages: to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer: to consider the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden fairly among the individual members of the community: and to make recommendations consistent with maintaining the same total yield of the existing duties in relation to the national income."

NOTE

For the guidance of intending witnesses the Commission published a list of the main heads under which evidence was invited. They explained that the list was not necessarily exhaustive and that witnesses could put in evidence on questions not specifically mentioned, provided that they fell within the Commission's terms of reference. The list is reproduced below.

A. General social and economic questions

1. Is the present system of taxation satisfactory, or could it be improved, in relation to:—
 - (a) incentives,
 - (b) risk bearing,
 - (c) encouraging savings,
 - (d) the control of inflationary or deflationary tendencies,
 - (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment,
 - (f) its effect on the distribution of personal incomes,
 - (g) other economic and social objectives?

These questions can be considered in relation to the taxation of:—

- (i) salaries and wages (P.A.Y.E.),
- (ii) profits of businesses and self-employments,
- (iii) dividends and other sources of income.

2. Would it be advantageous to link Income Tax with social security payments and contributions?
3. Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

B. Particular matters

4. Is the taxation net drawn too widely or too narrowly in relation to:—
 - (a) the taxation of United Kingdom residents (companies or individuals) on overseas profits,
 - (b) the taxation of non-residents on United Kingdom profits,
 - (c) the definition of residence, etc.?
5. (a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particular—
 - (b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?
6. Is the basis of computing income from property under Schedules A and B satisfactory?
7. Should the present rules about deductions for outgoings and expenses be altered?
8. Are the provisions for relief in respect of double taxation satisfactory?
9. Should the present system of graduation by means of the exemption limit, personal allowances, reduced rate relief and Surtax be altered?
10. Should the existing differentiation between earned and unearned income be extended or reduced?
11. Are alterations necessary in the rules governing personal and other allowances?
12. Should the rules about the taxation of husband and wife be altered (a) as regards aggregation; (b) in any other respect?
13. Should P.A.Y.E. be altered or abolished?
14. Should the principle of deduction at source be extended or restricted?
15. Should the method of assessment to Surtax be altered, and in particular should it be deducted from salaries?
16. Are any alterations desirable in the system of administration and the functions of the various statutory bodies or persons connected with taxation?
17. Are any changes in the provisions against avoidance and evasion desirable?
18. Is any alteration necessary in the rules governing the taxation treatment of special classes of taxpayers (e.g., public corporations, co-operative societies, charities)?

MINUTES OF EVIDENCE TAKEN BEFORE
THE ROYAL COMMISSION ON THE TAXATION OF
PROFITS AND INCOME

SEVENTH DAY

Friday, 23rd November, 1951

PRESENT:

MR. J. MELLARD TUCKER, K.C. (*in the Chair*)

Mrs. VERA ANSLEY, D.S.O.
MR. H. I. BULLOCK
MR. W. S. CARRINGTON, F.C.A.
MR. W. F. CRICK
MR. HARRY GILL, J.P.
MR. J. E. GREENWOOD
MR. GEOFFREY HEYWORTH

MR. J. R. HICKS, F.R.A.
MR. N. KALDOR
MR. W. J. KIRSWICK
MISS L. S. SUTHERLAND, C.B.E.
MR. G. WOODCOCK
MR. E. R. BROOKES (*Secretary*)
MR. D. G. DAYMOND (*Assistant Secretary*)

MR. H. N. HUME, C.B.E., M.C. accompanied by MR. W. R. L. WARNOCK; called and examined.

MEMORANDUM SUBMITTED BY MR. H. N. HUME, C.B.E., M.C.

1. I have been invited to give evidence on the contention of industry's spokesmen that current rates of taxation result, in current conditions, in the withdrawal through taxation of capital resources, with a resulting diminution of industry's capacity for production.

2. My qualifications to speak on this matter are largely bound up with my experience as Chairman of the Charterhouse group of companies. In this connexion it may be recorded that since 1945 The Charterhouse Finance Corporation has sponsored 65 share and loan capital transactions involving a total of £28,356,256, of which £13,591,4 represents the provision of new capital for industry; and that since 1935 Charterhouse Industrial Development Company has, as a principal, invested £6,539,671 in 64 companies which appeared to merit new capital not available to them through normal market channels. We maintain our association with the companies which we have sponsored and keep in intimate touch with those in which we are interested as principals. In addition, we carry out many investigations which do not lead to business. From all of this, we have built up a considerable knowledge of the financial problems facing industry.

3. I am convinced that industry is being deprived through taxation of part of its essential capital. I do not, however, subscribe to the view that this is the result solely of high rates of taxation. I consider that monetary inflation is the basic factor involved; and that the difficulties to which it alone would in any event give rise are greatly intensified by the taxation at high rates of "profits" arrived at without regard to the effect of inflation on the accounting principles normally employed in assessing them.

The effect of monetary inflation on net current assets

4. In a manufacturing company, the minimum required working capital bears a reasonably constant relation to rate of monetary turnover. Inflationary increases in costs and prices therefore require that additional working capital be provided even in the absence of any increase in the physical volume of production.

The only internal source of such additional capital is retained profits—falling a sufficiency of which (or of previous free cash reserves), either new capital must be introduced from external sources or the physical volume of production must diminish.

The effect of monetary inflation on fixed assets

5. Wear and tear and allied allowances are intended to enable companies, before being assessed to tax, to provide for the replacement of plant. The allowances are in the majority of cases limited to the historical cost of the items concerned.

In a period of inflation, actual replacement cost exceeds historical cost. The excess represents an increase in the amount of money which must be invested in the fixed assets required merely to maintain the existing physical volume of production. Again, it can only come from retained profits or from new capital.

Taxation rates and accounting principles

6. In the economic sense, a company cannot be said to have made a profit out of its operations unless full provision has been made for maintaining and, in due course, replacing the fixed assets which it requires to sustain an undiminished physical volume of production.

Fixed assets cannot be employed without their attendant clothing of stocks, work in progress, debtors and creditors. As in the case of fixed assets therefore, it is necessary to provide for the replacement of current assets before a figure of economic profit is arrived at.

In a period of inflation such maintenance and replacement requires, as we have seen, increased monetary investment under both heads. This is now fully appreciated by the leaders of industry and by their professional advisers. No generally acceptable accounting method has yet been evolved to meet this requirement. It is in the majority of instances provided as far as possible by the retention of a high proportion of "distributable" profits.

The calculation of profits for tax assessment purposes takes no account, however, of inflation's effects. As a result, taxation is levied on "profits" which can only be translated into cash during a subsequent deflation—or by a reduction in physical output.

7. The inherent factors involved are not new. But the current combination of sharp inflation and of company taxation involving upwards of 50 per cent. of assessed profits is new. And it is obvious that failure to admit the validity of the economic deflation of profit becomes progressively more serious as inflation and rates of taxation mount. The first increases the gap to be bridged; the second reduces the amount of available retainable taxed "profits" out of which companies can, from their internal resources, contribute towards bridging it.

8. I have prepared and attach as Appendix A to this letter a five year history of a hypothetical manufacturing company illustrating the effects of the above factors in current conditions. The assumptions on which the illustration is based are set out at its head and are, I think, entirely reasonable. It will be seen that the following points arise:—

(a) An aggregate "profit" of £146,522 is made subject to depreciation of fixed assets.

The comparable figure in the absence of inflation would have been £120,000.

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Mr. H. N. Hume, C.B.E., M.C.

[Continued]

(b) After providing for annual dividends equivalent to 6½ per cent. per annum gross on the employed capital at the commencement of the five years, for depreciation and for taxation, the amount retainable out of this £146,522 is £27,154.

In the absence of inflation it would have been £14,025.

(c) Of the total taxation charged (£66,868) £24,664 arises from the inflationary increase (from £80,000 to £128,841) in the cost of an unchanged physical volume of stock.

(d) The net amount employed in financing stocks and net debtors is increased, in step with the monetarily inflated turnover, from £100,000 at commencement to £161,051 at the end.

In the absence of inflation, no increase would have been necessary.

(e) This increase of £61,051 is financed as to £8,897 by way of net increase in future tax liability over cash available to meet it; as to £27,154 out of retained profits; and as to £25,000 by the application as working capital of the depreciation allowances which should be held available in cash for replenishing worn-out plant.

(f) It is apparent that as and when the depreciation of the fixed assets reflected in the assumed depreciation charges of £25,000 requires to be made good by replacement, fresh capital will have to be raised for the purpose. As the £25,000 is a proportion of a money cost incurred prior to the inflationary period postulated, replacement will clearly call for the investment of a greater sum.

In the absence of inflation, the depreciation charges of £25,000 would have resulted in an equal increase in cash resources, as would have the £14,025 of retained profits. Inflation has therefore worsened the company's immediate cash position by £39,025 plus the excess over £25,000 of the cost of replacement of the depreciated fixed assets.

9. I cannot see that any un-biased consideration of this whole problem can fail to conclude that the factors which I have outlined and illustrated operate to a greater or lesser extent in every capital-employing company today. I am aware that my arguments would carry more immediate conviction if they could be supported by a composite table of the figures of a number of actual companies. But the impact of inflation and all that goes with it varies so greatly even between companies in the same trade (because for example of differing dates of purchase of basic plant or differing "gearing" of loan and share capital) that such composite figures could only be put forward as the result of accountancy and statistical analysis far beyond the resources available to me. Even then, the attempt to eliminate for purposes of comparison the elements of increased production and productivity per se could only be theoretical; and these elements are inherent in the majority of the companies with which we have been or are associated. I do, however, attach as Appendices B-E the figures of 4 actual companies for representative periods. These have been selected for absence of extraneous obscuring factors and they are to that extent un-representative; but they do throw up the trends discussed.

10. As I have stated, it appears to me inescapable:—

I. That inflation of itself requires the provision of increased fixed and net current asset investment if physical productivity is to be maintained; and

II. That current taxation practice causes tax to be levied on "profits" which include unreliable inflationary stock and net debtors increments and which are struck before providing for maintenance of fixed asset productive capacity.

11. The extent to which individual companies can increase investment under I from within must vary widely; but current high rates of taxation levied as in II clearly restrict their ability to do so.

12. In the hypothetical example the assumptions barely permit the necessary increase in working capital from year to year at the expense of plant replacement reserves. In the Economic Survey for 1951,* Table 23, Profits, Depreciation and Other Income are apparently taken at between £m.5,600-6,000 of which some £2,800 m. will, by comparison with 1950, apparently arise in the form of company and public corporation profits. Table 26 estimates Stock Appreciation in companies and public authorities in 1951 at £700 m., giving a ratio to profits of about 3:1. The comparable aggregate figures in the hypothetical example are £146,522 and £48,841 respectively—a similar ratio. It would thus appear probable that my example is in this respect representative of overall national experience. If reference is made to paragraph 8 of the memorandum, it will be seen that the taxation arising on stock appreciation, £24,664, is approximately equal to that part of the inflationary increase in working capital not capable of being provided out of retained profits or deferred taxation payments. It seems not unreasonable to assume that this is substantially the recent experience of British industry as a whole.

13. No comparable calculation is to my knowledge possible in connection with fixed asset replacement. According to Table 24 of the Survey, however, gross fixed investment has run at about £2,000 m. per annum for some years compared with depreciation allowances of about £1,000 m. per annum. It is difficult to avoid the conclusion that the bulk of the difference represents excess replacement cost.

14. If the conclusions arrived at in these last two paragraphs are even approximately accurate, and failing alleviation of the position by effective reduction of the overall weight of company taxation, I am driven to the further conclusion that the full cost of replacement of industry's fixed assets will require sooner or later to be financed by the introduction from outside sources of fresh capital. This I consider to be objectionable in that each injection of fresh capital increases the absolute amount required to be paid away in interest or in dividends and, owing to the incidence of Profits Tax, in taxation—whereas the whole of my evidence is to the effect that while retainable "profits" in the accepted sense rise with inflation, they do not and cannot rise fast enough to provide for the maintenance of the fixed and current assets which together constitute the first of the three factors—capital, management and labour—which in themselves constitute physical productive capacity.

15. I stated in the first place that I did not subscribe to the view that high tax rates were the source of the trouble—which I have endeavoured to show as originating from monetary inflation aggravated by an un-economic form of taxation accounting and high taxation rates. I would now qualify this to the extent that high company taxation is itself clearly inflationary. Profits are, where possible, increased to provide the resources to combat inflation. Taxation takes the bulk of the profit increment. The balance is insufficient and new capital must be raised. Higher interest or dividends and profits tax charges have to be paid away, inflation's effects continue, profits must again be increased—and so on, all from an un-increased volume of production. With that one proviso, however, I assume that the responsible authorities are containing inflation to the best of their political and technical ability. I think it extremely unlikely that professional accountants will in the immediate future evolve a fresh technique applicable to inflationary conditions and acceptable to the taxation departments. Believing as I do that the problem is vital and urgent, I therefore see no alternative but to tackle it immediately by reducing in appropriate cases the effective weight of company taxation.

*Cmnd. 8195.

23 November, 1951.]

Mr. H. N. Hume, C.B.E., M.C.

[Continued]

TRADING ACCOUNTS OF YEAR

	1.	2.	3.	4.	5.	Aggregate Trading Figures
	£	£	£	£	£	£
Turnover	240,000	264,000	290,400	319,440	351,384	1,465,224
Earnings before Depreciation	24,000	26,400	29,040	31,944	35,138	146,522
Wear and Tear	5,000	5,000	5,000	5,000	5,000	25,000
Taxation on year's profits	10,605	11,907	13,240	14,706	16,320	66,868
Net Dividend	5,500	5,500	5,500	5,500	5,500	27,500
RETAINED PROFIT	21,195	22,407	23,740	25,206	26,820	107,154
	£2,805	£3,993	£5,300	£6,758	£8,318	£27,154

COMPARISON of aggregate 5 years' results disclosed above with results which would have arisen in the absence of necessary inflation

1. Earnings with inflation total £146,522. Without inflation they would have totalled £120,000 ($5 \times £24,000$ as Year 1 above).
2. Despite the increased earnings, cash resources have with inflation dropped from £6,000 to £2,409; and future tax liability has increased from £6,000 to £11,306—a net worsening of £8,897. Without inflation, cash would have increased from £6,000 to £45,820; and future tax liability would have increased from £6,000 to £6,795—a net improvement of £39,025 (made up of 5 years' retained profits as Year 1, £2,805 and 5 years' retained depreciation at £5,000 per annum).

N.B.—If for the taxation rates assumed above were substituted those proposed in the Finance Bill 1951, the aggregate taxation over the above 5 year period would be increased from £66,868 to £74,602, while aggregate net dividend would be reduced from £27,500 to £26,250.

The balance sheet at the commencement of Year 6 would then be as opposite.

	£	£
Fixed Assets at W.D.V.	...	...
Stocks	138,841	...
Trade Debtors	64,420	...
Cash	...	...
	193,261	25,000
Liabilities	...	...
Bank Overdraft	32,230	...
	4,397	...
	156,654	...
Future Income Tax	...	...
	181,654	10,984
	£270,670	...
	Balance Sheet	...

23 November, 1951]

Mr. H. N. Hume, C.B.E., M.C.

[Continued]

Appendix B

A TEXTILE MANUFACTURER.

	1946	1947	1948	1949	1950	1951
As at 28th February.	£	£	£	£	£	£
Fixed Assets	50,062	80,094	62,470	68,826	71,358	77,112
Current Assets	116,172	133,178	232,572	235,008	328,945	395,597
Stock and Debtors	27,224	53,013	2,184	2,812	4,518	660
Cash and T.R. Certs	—	186,191	234,756	237,820	333,663	396,257
	143,396	—	—	—	—	—
	191,458	236,285	297,226	306,646	404,821	473,369
Liabilities	93,025	71,317	80,690	114,240	151,811	184,131
Taxation	40,786	58,123	43,280	52,175	51,137	49,517
Overdraft	—	—	59,180	14,867	61,671	90,961
	135,811	129,440	183,150	181,242	266,659	324,609
	—57,667	106,845	114,076	125,364	138,202	148,760
	831,809	770,802	952,020	1,207,172	1,115,288	—
Year commencing 1st March						
Turnover	78,400	52,842	72,245	72,845	66,988	343,320
Earnings before Depreciation	—5,285	6,311	9,147	10,007	11,330	42,680
Depreciation	53,000	26,100	38,610	34,600	31,900	184,230
Taxation	11,000	13,200	13,200	15,400	13,200	66,000
Dividends (net)	—	45,611	60,957	60,007	56,430	—
	69,285	—	—	—	—	—
	9,115	7,231	11,288	12,838	10,558	51,050
RETAINED PROFIT	—	—	—	—	—	—
Additional Capital	40,000	—	—	—	—	—
E.P.T. Refund	83	—	—	—	—	—
	—	—	—	—	—	40,083

Aggregate
Trading
Figures

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Mr. H. N. Hunt, C.B.E., M.C.

[Continued]

Appendix C

AN IMPORTER OF PRIMARY PRODUCTS

	1945	1946	1947	1948	1949	1950
As at 31st March						
Fixed Assets	£	£	£	£	£	£
Stocks	19,972	68,557	71,672	81,146	70,371	92,911
Debtors	35,674	15,057	24,685	77,643	71,451	141,556
Cash	22,866	68,394	68,864	29,878	88,257	105,461
		38,456		22,442		2,133
Creditors	78,512	122,107	142,359	188,667	182,150	253,180
Bank Overdraft	17,152	22,093	26,643	55,572	46,957	75,226
						58,594
Future Tax	£	£	£	£	£	£
	61,360	100,014	115,716	133,095	138,193	189,130
	131,284	168,577	187,382	202,489	205,564	212,341
		25,171	32,000	30,000	27,000	22,327
	131,284	143,400	155,382	172,489	178,564	189,914
Year Commencing 1st April						
Turnover	940,813	946,062	943,650	414,862	439,334	Aggregate Trading Figures
Earnings before Depreciation	45,709	53,262	58,228	49,044	45,083	251,346
Depreciation	2,000	3,993	3,859	4,521	4,521	17,605
Taxation	24,316	30,000	27,000	22,327	22,327	139,890
Net Dividends	5,277	5,134	10,110	4,065	4,065	30,597
	31,593	44,670	39,127	40,969	31,733	
	14,116	8,612	19,101	8,075	13,350	63,254
Fixed Capital introduced		5,376				5,376
Fixed Capital withdrawn	2,000	2,000	2,000	2,000	2,000	10,000

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MR. H. N. HUME, C.B.E., M.C.

[Continued]

Appendix E

AN ENGINEERING MANUFACTURER

As at 31st December	1944	1945	1946	1947	1948	1949	1950	
Fixed Assets	£ 24,441	£ 26,035	£ 27,371	£ 29,328	£ 31,036	£ 35,283	£ 43,148	
Current Assets								
Stock and Debtors	101,207	90,867	131,036	156,971	154,036	175,043	193,899	
Cash and T.R. Certs.	10,064	1,968	457	623	253	155	306	
	111,161	92,835	133,493	157,592	154,289	175,198	194,205	
	135,802	118,470	162,864	186,920	185,325	210,483	237,353	
Creditors	31,135	27,576	36,701	40,770	26,295	29,279	26,622	
Taxation	17,200	3,581	11,169	16,832	24,581	26,909	33,089	
Overhead	6,471	5,612	29,226	26,598	25,260	6,889	16,055	
	54,306	36,769	77,676	84,200	76,136	63,077	75,736	
	80,996	82,101	83,788	102,720	109,189	147,406	161,617	

Aggregate
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Figures

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Mr. H. N. HUME, C.B.E., M.C.

[Continued]

EXAMINATION OF WITNESS

1756. Mr. Millard Tacker: Mr. Hume, the Commission are very much obliged to you for all the trouble you have taken in preparing this paper, particularly because you have given us actual figures. There are just one or two points I would like to go over with you. Have you got your own figures before you?—Mr. Hume: Yes Sir.

1757. Before we look at the figures, I have just picked out of your paper two sentences which seem to me to sum up your point of view. You are dealing of course in this paper mainly with this troublesome question about replacement cost and allowances for replacement cost, are you not?—Yes.

1758. And you have read the conclusions of our first Committee* on this point?—Yes.

1759. You may remember that what we suggested was that the real trouble was that the rate of tax was much too high, that is to say, too much is being taken out of the business in the form of tax to enable the business to have enough left to finance its own development in a period of inflation.—That is so; that is my own view too.

1760. You say here, in the third paragraph, "I do not, however, subscribe to the view that this is the result solely of high rates of taxation". The emphasis there is I think on the word "solely", is it?—It is.

1761. Because at the end of the paper you come back to the point and say that you did not subscribe to the view that high tax rates were the source of the trouble but you endeavoured to show that it was originating from monetary inflation aggravated by an uneconomic form of taxation accounting.—Yes.

1762. And the uneconomic form of taxation accounting is purely this question of depreciation allowances on historical cost as against depreciation allowances on replacement cost. Is it not?—That is the case as far as fixed assets are concerned. Then of course there is the other question of current assets, stock, which might have to be subjected to a slightly different treatment.

1763. Yes, I gather that. You then refer us to your first illustration in actual figures which is your Appendix "A". You begin with a number of assumptions to which I will refer in a moment and your conclusion upon that is in (f) of paragraph 8. It is the second paragraph of (f) I want to take up with you. You say that in the absence of inflation in this hypothetical business, the depreciation charges of £25,000, that is over the five years, would have resulted in an equal increase in cash resources, as would have the £14,025 of retained profits. Inflation has therefore worsened the company's immediate cash position by £39,025 plus the excess over £25,000 of the cost of replacement of the depreciated fixed assets. What I understand you to say is that you have demonstrated by this example that, as a result of inflation plus the uneconomic form of tax accounting, this business should have had at the end of this five year period £25,000 more in cash plus an extra amount of cash to cover the increased cost of replacing the fixed assets.—No, if I understand it rightly, this is the position: but for inflation this company which, as you will see, begins with £6,000 cash would at the end of the period have been able to retain £25,000 plus £14,000, £39,000. In other words, that cash item at the end of the line but for inflation would be £39,000 plus £6,000, say £45,000. The point that I am trying to make is that it has not got £45,000; it is unable to finance the replacement of fixed assets in this example, it is merely able to keep going with its existing assets.

1764. Yes. You are looking now at the beginning of the year 6 which is the same thing as the end of year 5, are you not?—Yes.

1765. And you say the cash figure there should have been £27,409 instead of £2,409.—Perhaps Mr. Warnock who is an accountant, Mr. Chairman, might explain the figures better than I. I, as you already know, am no accountant, I have even less knowledge of taxation and I am certainly not an economist. I feel very diffident at appearing before you at all. Mr. Warnock is a chartered accountant and I hope he will be able to explain the figures. In fact he was responsible for preparing this table.

1766. Perhaps I had better address my questions to him.—Mr. Warnock: Shall I continue, Mr. Chairman?

1767. Yes.—The point we were trying to illustrate here is that in this example under the hypothetical conditions which head it, this company starts off with £6,000 cash which is, as you will see, exactly equal to its future tax liability. It finishes up under these hypothetical conditions with £24,000 cash and a future tax liability of £11,000 odd. There is an obvious loss of cash there. Separately both at the end of this Appendix "A" and in the second part of paragraph 8 (f), we tried to state what would have happened had the hypothetical conditions not existed in so far as they are brought about by inflation, and we have worked out that the company in these non-inflationary conditions would, in fact, have finished up with cash to the amount of £45,025 made up of the £6,000 with which it started, the depreciation allowances of £25,000 retained for the sake of the hypothetical example in cash, and the retained profits of £14,025, which last is built up of five years equivalent to the first year shown in the example.

1768. I follow.—So that in non-inflationary conditions it would, at the end of this five year period, have had £45,000 in cash compared with the position shown under the inflationary conditions which you have in the example. In addition, under the inflationary conditions, it has at some time to replace this plant; the replacement cost equivalent to the depreciation allowances of £25,000 will not be £25,000 but something vastly greater because of inflation. That is the point we are trying to draw out here.

1769. I see. The accuracy of that conclusion depends to some extent, does it not, upon whether the cash figure of £2,409 is the right figure in this calculation?—Certainly.—Mr. Hume: But it is the right figure in this calculation.

1770. In this calculation it is the right figure?—Yes.

1771. I am just wondering whether it is. I just want you to help us if you would. The first part of this hypothetical company's affairs is set out in its balance sheet. Mr. Warnock, I think probably you will have to answer these questions rather than Mr. Hume because you prepared the table. You give the balance sheet at the commencement of each of the five years. In the beginning of year 1 we start with fixed assets £50,000, stocks, trade debtors, cash, and we deduct the trade creditors, giving the net liquid assets or current assets £106,000. Then there is future income tax; on what profits is that future income tax payable?—The first figure of future income tax of £6,000 is presumed to be payable as the result of the previous year's profits which are not shown here.

1772. It is really the future income tax payable on profits of the year minus 1?—Mr. Warnock: Correct.—Mr. Hume: This is not an illustration of a new business formed in the year 1, it is five years out of the life of a business.

1773. Quite, I just wanted to get that clear. Now we look underneath at the actual results of the year. Your turnover is £240,000 and you earn, before you charge depreciation on that turnover, £24,000; I follow that. Now wear and tear means that the company has made a reserve for depreciation out of these profits of £5,000.—10 per cent. on the fixed assets.

1774. Yes, and then there is taxation on the year's profits, which is profits tax.—Mr. Warnock: Profits tax and income tax.

1775. Yes, and the net dividend which you pay out is cash of £5,500, and that reduces your retained profit to £2,805. Now, that is what happened during year 1.—Yes.

1776. So that you begin year 2, looking again at the balance sheet figures, with an increase in your net assets, or your employed capital as you describe it there, of £2,805, which is the amount of the retained profit from the previous year, that is right, is it not?—Correct, yes.

1777. That is how all these figures year by year are made up?—Yes.

1778. Taking your hypothesis of year 2 you have to treat your stocks as being £58,000, your trade debtors as £44,000, your cash then goes down to some extent, your

* Committee on the Taxation of Trading Profits. Cmd. 8189.

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trade creditors go up by their 10 per cent. too, and so really that cash of £4,000 is a balancing figure?—It is the figure with which you would be left, Sir, if you were running this business under the hypothetical conditions stated.

1779. What puzzles me is that if in the year 1 you have made a profit of £24,000, before anything happens to the profit you will have assets representing that profit, will you not?—And certain liabilities, Mr. Chairman, accruing tax. . . .

1780. Yes, but before dealing with any question of payment out of the profits anywhere you will have had £24,000 increase in your assets?—Yes.

1781. Now £10,000 of that goes in tax?—Yes, taking the future tax as "going" in your sense.

1782. Your reserve for tax. £5,000 is actually outgoing as dividends?—Yes.

1783. What happened to the £5,000 worth of assets represented by the reserve for wear and tear?—If I can go back just one stage you will see that as between years 1 and 2 the amounts sunk in the same physical volume of stock as before ex-hypothesis, trade debtors representing the same physical volume of turnover as before ex-hypothesis, and conversely the creditors which are deducted, the net increase as between the two periods is £10,000. That is cash drawn out of this business in one case in the form of stock and in another case in the form of debtors less creditors. It is drawn out by the process of inflation, and it is drawn out of cash. So that the cash which as you stated is available by making a profit, before wear and tear, of £24,000 has had removed from it the sum of £5,000 for dividend; £10,000 which we have just discussed as being the net increase in stocks and debtors less creditors, that makes £15,000. The profits tax which, in theory at any rate, is payable on the day after the last day of the period and is treated here as payable on the last day of the period, must come to some £2,000; that I think adds up to £17,500. We have a retained profit of £2,500 which brings it to some £20,000. On-hand, I cannot tell you what the remainder is, but it is not in the form of cash.

1784. This £5,000 that you have reserved out of profit will be represented by some assets or other; it does not matter what the assets may be, cash or otherwise.—The wear and tear of £5,000, certainly, yes.

1785. Comparing year 2 with year 1 where has that £5,000 disappeared to?—It has been sunk in the current assets.

1786. But surely not.—Mr. Hume: The £80,000 has gone up to £88,000 and the £40,000 has gone up to £44,000, that is a £12,000 increase in itself.

1787. But look at the net position at the beginning of year 1 and at the end of year 1. You began with £150,000, you end up with £152,805, the increase being a retained profit, but the £5,000 is also a retained profit.—Mr. Warnock: It is certainly retained, but not in the form of cash.—Mr. Hume: We have dealt with that by taking it from the fixed assets. We could have left the fixed assets as a constant and put in that £5,000 elsewhere; it still would have been £5,000 non-cash.—Mr. Warnock: If you would care for me to take the time, I can assure you the cash positions between each successive year in this example have been worked out exactly in accordance with the cash transactions that took place. You will find that each year you are paying the previous year's income tax apart from anything else. It is a lengthy process, but it has been done, and I am sure if you submit it to the same process you will arrive at the same result as we have arrived at here.

1788. I quite agree, but you have made that £5,000 disappear merely by altering the book figure of the fixed assets—I am sorry, but I do not follow what you are getting at.

1789. I am checking this cash figure because my own experience has been the contrary to this in a practical case which is very nearly like it in which the cash has gone up. If, starting at the year 1, you earn £24,000 worth of profits in that year your assets will go up by that amount, will they not?—Yes, until you take some other action.

1790. Until you take some other action. £24,000, taking it by stages, represents at that stage an increase in the net assets of that company, does it not?—Yes.

1791. Making them £174,000?—Yes.

1792. Now, what actually goes out in the form of cash is only £16,195—I presume, in arriving at that figure, you are adding the taxation on the year's profit to the net dividend?

1793. I am taking your own figures, Mr. Warnock, that the taxation £10,000 and the net dividend absorbed together £16,195.—That is so, but I would point out that only part of taxation disappears in that year in cash.

1794. Yes, all right, I do not mind that, but you have assumed in this illustration that you have paid it out. You may say you will not in fact have done so, but it is one of your assumptions.—I do not wish to contradict you directly, but we have not assumed we have paid out in the year 1 the income tax arising on that year.

1795. No, that is not what I am saying. You began that year with a liability of £5,000, being the income tax payable on the profits of the year minus 1.—Yes.

1796. You have profits tax to pay on the profit of the year 1 and together I gather they come to £10,695.—The £10,695 is profits tax and income tax on a profit of £19,000, that is to say £24,000 earned before depreciation, less £5,000 depreciation.

1797. I follow. All right then, in that event we ought to start off with showing part of that taxation as a liability and the amount to meet it in the company's coffers.—I think we have done so in the year 1 here. You will find we start off with the assumption that the future tax liability, to use an accounting term, is £6,000 and there is exactly that amount of cash available in the company to meet it. That was intentional.

1798. What I am checking is the actual asset position at the beginning of the year 2, the end of the year 1. Unless you have actually paid your income tax on the profit of the year 1 during that year, and unless you paid your profits tax during that year, you would have the cash in hand to meet it?—Yes.

1799. So what I say you have assumed in the bottom half of this illustration of the year 1 is that you have paid your income tax on the profits of the year 1.—Mr. Hume: No, that is where you are wrong. You have paid the £5,000 which is up above.

1800. It seems to me that makes your illustration worse, if that is right.—Mr. Warnock: Mr. Hume is correct. We have tried to follow through in this broadly what happens, and what happens is that you pay in year 2 the income tax arising from the profit of year 1. That is the basis on which this illustration is drawn up. While we have been talking, Mr. Chairman, I have very quickly jotted down a few figures; they may help. We start off in year 1 with £6,000 cash, and we make profits during that year of £24,000, as you stated. You are seeking, as I understand it, to find out where that £24,000, which is presumably in cash at one stage, but not continuously, has gone. I would like to suggest in the first place that a net amount of £10,000 has been sunk in increased stocks and debtors less increased creditors. Secondly £5,000 has been paid out in dividend. Thirdly, £6,000 has been paid out in respect of last year's income tax, and fourthly, we agreed that £2,505 is retained. In addition to that there is profits tax to the tune of £1,500 I think on these figures.

1801. Mr. Carrington: Are you right on that point? I think that is where you have gone wrong.—Mr. Hume: Extra profits tax on the £5,000 has been added.—Mr. Warnock: I think Mr. Carrington has been kind enough to work out these figures, but the first four I mentioned, increase in net stocks and debtors, the dividend, the payment of last year's income tax and the retained profits together come to £24,305 either paid out or sunk out of cash.

1802. Mr. Kaldor: May I ask a question on that point? I think I see where the trouble is, if I am right, about this net amount of £10,000 sunk in stocks, etc., in your illustration. The £24,000 is earnings in the sense that it is excess of receipts from the sale of goods during the year over purchases. Is that right?—No, it is not right. It is the excess of receipts from the sale of goods over the year

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over the cost of these goods based on historical cost figures, not based on what has been paid for the replacement of these goods in the year. That is one of the difficulties.

1803. May I just ask one or two more questions. You mean that £24,000 is not the difference between what the firm actually received and what the firm actually spent on the purchase of goods during the year?—It would be most unusual for the circumstance which you have postulated to occur. If a company carries stocks, as all manufacturing companies must, then in a period of rising prices it will pay out in any year, for the replacement of these stocks which are sold, more than the "cost" of the stocks which are sold. The profit is calculated in present conditions on the excess of receipts in the year over the cost of goods in a previous period. In an inflationary period that cost is clearly less than what has to be paid out now.

1804. Then that example assumes that the margin of profit on turnover is decreasing with inflation; yet you say it is always assumed to be 10 per cent. Either you must assume that this £24,000 is receipts minus sales during the year and then, in order to get the profit, you have to add to it the increase in the value of the stocks, or this £24,000 represents both items taken together, receipts minus sales during the year plus an increment in the value of stocks over the year. Then the reason why this calculation is wrong is because profit as a percentage of turnover is continually falling. Otherwise, with the rise in stocks, the amount earned before depreciation has to rise more than in proportion to the rise in turnover. That is I think why this cash problem arises.

1805. Mr. Millard Tucker: Takes your first line of the balance sheet. You have assumed in this that every year your fixed assets are £5,000 a year less than they were in the preceding year. In fact you know there is no outgoing of £5,000 at all in respect of fixed assets.—We did not mean to suggest that there was, if by outgoing you mean an outgoing in cash. It is stated I think several times through the memorandum, particularly in paragraph 8 (f) which we were looking at, that the effect of depreciation charges or wear and tear, or whatever you like to call them, should be in normal circumstances to allow the business to accumulate cash equivalent to their exact amount. That is a normal accounting concept.

1806. But Mr. Warnock, what I am suggesting is that in the second year, if your figures of the first year are what you assume them to be, your cash instead of being only £4,000 will be £9,000.—That is not the case. The extra £5,000 which you are talking about will, among a multitude of other transactions, have been sunk in the extra current assets required to keep this business going at the same physical level in each year.

1807. You have set out all those assets here, there are no other assets you have in mind, are there?—Mr. Hume: May I mention this. Supposing we kept that first item £50,000 throughout. There is then on the liability side to make the balance sheet balance £5,000 to be injected, and it is, is it not, depreciation reserves?

1808. But it must be represented by an asset.—But you still have a balance; if you add £5,000 to one side you have only to add £5,000 to the other and you are balanced.

1809. Mr. Hume, are you not confusing the credit balance on the profit and loss account with the assets which represent it? If, instead of putting your figures of £50,000, £45,000, £40,000 and so on you cross those out and put the word "plant" and then look at your actual assets, I suggest you will find that your cash increases at the rate of £5,000 per annum and you will end up with £27,409 instead of £2,409.—Mr. Warnock: Mr. Chairman, having had an opportunity of doing a quick calculation while Mr. Hume was replying, I think we can now settle this cash point for you. Referring to year 1, we start, by hypothesis, with £5,000 . . .

1810. That immediately goes away.—Might I just run through this to show how I see it? We start off with £5,000 in cash. During the year the net cash transactions on debtors, stock and creditors increase the amount sunk out of cash into those assets by £10,000; that is to say, in the first year we have £90,000 of stocks plus £40,000 of debtors less £20,000 of creditors, in the second

year we have £98,000, £44,000 and £22,000 respectively, and the net difference there is £10,000. That has to be found from somewhere, this relates to Mr. Kaldor's point a moment ago, it is cash converted into assets of another form, so that in effect, we have to spend that £10,000, to start off with. Secondly we say we pay out £5,500 net dividend. Thirdly we have to pay last year's income tax which we take at £6,000. Fourthly we have to pay this year's profits tax, and Mr. Cunningham has put me on the right line there; it is not only £1,900 undistributed profits tax, there is also £2,000 worth of distributed profits tax arising on the dividend; those two together coming to £3,900. If you add up the figures which I have just given you, you will find they come to £25,400, as against which we have made a profit on a normal accounting concept of £24,000, so that somewhere, on your own statement that the profit came in in cash at one stage and amounts to £24,000, and that we have paid out in cash in one form or another £25,400, I think you will agree that £1,400 net goes out in the form of cash.

1811. Yes.—That happily corresponds to the difference between our opening and closing cash balance, £6,000 and £4,600. I must apologise for taking so long to get at it, but we did not expect to be pinned down to the detailed figures making up this Table.

1812. Is it not rather odd that each year your net assets increase by the amount of retained profit exactly, but in addition to that retained profit of £2,905 in the first year you have also retained £5,000 worth of profit to become a depreciation reserve? Both the £2,905 and £5,000 will be represented somewhere in the assets; I do not care where it is, but they will be there somewhere will they not?—Undoubtedly. They are in fact sunk in stocks and debtors.

1813. Therefore I suggest that comparing the year 1 balance sheet with year 2 the increase should not be £2,905, but it should be £7,805.—Mr. Hume: No, Sir, I think we should have made this illustration clearer if we had kept that top line at £50,000 throughout and had gradually injected immediately underneath it "less depreciation reserve" which had built up £5,000 each year until of course in the year 6 it would be £30,000 in line 1 less £25,000 in line 2, and throw out £5,000. That would have illustrated rather more vividly what we are trying to put.

1814. Mr. Hicks: I have been worried about these figures because we are not really shown in this table any basis of comparison. The first year as shown is already a year apparently where the inflation has started. The balance sheet shows the position at the beginning of the year followed by the position at the end of the year or, I think it is the same, the beginning of the second year and there is already inflation in that state of affairs. Would it be possible for Mr. Hume or Mr. Warnock to go back, let us say, to the year 0, assuming there is no inflation in year 0 at the beginning of the series so that, apart from the normal course of business, there should be no changes between the position at the beginning and at the end of the year. Could we be told what is implied in these figures about the trading accounts in particular of that year 0?—The year 0 you call the year before the year 1?

1815. The year when there was no inflation.—The figures would be the same as in year 1.—Mr. Warnock: Yes, they would. The inflation point is quite immaterial as regards the hypothetical profit and loss account which is shown here as being that of year 1. The assumptions, Mr. Kaldor is shaking his head, but the assumptions are that we make a net profit subject to wear and tear of 10 per cent.

1816. You do so whether or not there were . . .—We assume that that is what this company does on its turnover.

1817. Mr. Kaldor: There is something wrong here, if a company holds stock and prices are rising it must make a profit on its stock-holding.—You might think so, but we do not.—Mr. Hume: Perhaps you would like to look at illustration "B" which is a real live company trading from day to day. The stock and debtors has gone up from £116,000 to £395,000, and the profit has gone down.

1818. May I clear up these assumptions before we come to another example? What is the assumption underlying your hypothetical example? You take the profit

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always at 10 per cent. of the turnover of the year in each year, that is your basic assumption?—Mr. Warnock: Correct.

1819. Either you assume that the profit is 10 per cent. of the sales, which means that not only is a profit made on the sales but that you also have to add the profit made on stocks, the increase of value of the stocks for the year, to get the profit for the year; or else, if you assume that the profit shown there is the joint result of profits made from sales and profits made from the increase of values of stocks, then you are assuming, are you not, that this particular company makes a smaller and smaller profit on its sales each year, and that is the whole point. If you say it makes a constant per cent. profit on its sales then when prices rise its profits must rise more than in proportion to its turnover because there is also an increase in the value of stocks. If you take cash as the residue, this method is illegitimate because you cannot derive from your method how much the cash will be until you know what the profit will be, but you do not know what the profit will be until you know the difference in value of the assets between the beginning and end of the year. You are trying to derive the cash position as a residue which you cannot do by this method because you cannot tell what the profit is.

1820. Mr. Rickard: I think Mr. Kaldor is not speaking the same language as Mr. Hume and Mr. Warnock, but might I ask substantially the same point in another way. Would you consider in the year 0 when, by hypothesis, there was no inflation, the turnover would be the same as in year 17—Mr. Warnock: Yes.

1821. With prices rising during the year, and you do not get any larger volume of sales?—Mr. Hume: There was no inflation in that period.—Mr. Warnock: The overriding hypothesis is that we make a 10 per cent. profit on turnover. I will grant you that in so far as £240,000 is, as it were, the average which occurred during year 1, that being a year of inflation, one would expect in the previous year to have a lower turnover; that is your point, is it?

1822. Yes, that is my point.—It depends of course on the rate of inflation. If the inflation takes place on the last day, it would be better; if it takes place evenly we meet halfway, if it all takes place on the first day of the year. . . .

1823. Agreed.—I grant you if we had gone back to a year before this it is probable that the turnover would have been less, but I think the figures will stand so long as we take the assumption always that there would have been a profit of 10 per cent. I think you are coming down to the fact that the retained profit figure, £2,805, would in fact have been smaller in the year 0 as you describe it, but not much smaller, £2,600 or something like that. It does not alter the argument, Mr. Hicks.

1824. Mr. Kaldor: But you must take credit for the fact that the value of the stocks increases and that is part of the year's profits?—Mr. Hume: I am not sure. You are working on the assumption that the price of stocks rises during the comparatively short period they are in a trader's hands, and he makes a fortuitous profit that way, that is your assumption?

1825. He must.—I submit to you he does not always. The rate of net profit to turnover, despite the inflationary tendencies in real life if I may say so, and inflation "is" might be put forward as confirmation of it, does not rise in that way. The incidence of competition and other things makes it, in our judgment, correct to assume a profit on turnover during the current conditions at much more than 10 per cent. This is a net trading profit subject to depreciation only. It depends on various factors; if you have a very slow moving stock and a rapidly rising price level in that particular commodity, your argument is justified. If you have a fast moving stock in commodities which are not changing much in value the contrary is the case. This man is turning his stock roughly three times a year, so his average period of holding stock is four months.

1826. But still if you assume that prices are rising continuously throughout the year and on the average he is buying stock four months before he sells it, his profit must be augmented by the fact that the value of his stock went?—That is a possibility. A man selling goods at

fixed prices who does not alter his fixed prices is not able to take advantage of that. We have submitted some real life examples to you because we hope that they will help you as to the determination of the validity of these theoretical arguments. Take illustration "C", that Company's net profit earned before depreciation expressed as a percentage of turnover is in fact going down. The illustration in Appendix "B" shows the same thing. I do most seriously submit that in real life, if I may use that expression without giving offence, these theories do not hold good to the extent to which you gentlemen, who are theorists, believe.

1827. I just wish to find out what the assumptions in your hypothetical case are. The profit margin is such that . . . ?— . . . he cannot jack his prices up more than 10 per cent. each year. The profit margin is falling each year.

1828. He jacks it up less and less each year. This 10 per cent. is not a profit margin on the turnover, it also conceals stock appreciation in arriving at the profit figure?—I am prepared to say that that academically is the case.—Mr. Warnock: I see the point Mr. Kaldor is getting at. I think he is misguided in getting at it because the reduction in what he calls net profit is before allowing for stock increment, or whatever you care to call it. The assumption that that net profit must be dropping in a hypothetical example is only true if the rate of inflation is itself increasing as a rate. If it remains steady at 10 per cent. throughout the period concerned I do not think there is any validity in the point at all. The increase in stock values to which you refer is taken into account in the hypothetical figures shown here. We have stated already that the stock shown at £80,000 in the first year is shown at £84,000 in the second for the same physical volume of stock. That reflects your rise in prices owing to holding it, and it does in fact give rise to this profit of £24,000. That is assuming a steady rate of inflation of 10 per cent. per annum. If that rate suddenly increased to a higher figure, let us say 20 per cent. per annum, in the course of the period we are considering I agree you have a point. We have postulated that it does not so increase, so I do not think your point is valid.

1829. It is your point that as a result of the inflation that company is in a worse cash position after five years than it would have been under exactly identical trading conditions if the inflation had not taken place. What I wish to say is that I think that result of yours false because you have assumed, not that the rate of inflation increases progressively, but that while prices are rising the margin of profit as a percentage of the selling price is smaller all the time than when prices are constant; in other words, that the manufacturer not only does not pass on rising costs but he lowers his selling price while inflation lasts in relation to his costs. If you did make that assumption then the profit in the second year would be £26,400 plus £8,000 being an increase in the value of stocks, and when you say £10,000 cash had been sunk in the increase in value of stock, no cash would have been sunk because the profit would have been that much higher. That is the point I want to make, not that the rate of inflation is progressive.—Mr. Hume: I take it that you are not assuming that stocks are written up to market price. One must still maintain a valuation on the basis of the lower of cost or market price.

1830. There are two different years and prices have risen, that is what is reflected in your figures.—With great respect we must dissent from that view, and we put forward other appendices taken from real life which lend colour to our view.

1831. Mr. Kenrick: May I suggest we return to the more practical point that you were trying to establish, either that these figures are correct or not correct. Having established that they are correct perhaps we could then deal with these theoretical points later on. I would prefer it if you would go on.

1832. Mr. Millard Tucker: I think we ought to make quite sure that we are first of all talking about the same things. Mr. Warnock, would you just help me to see the matter, perhaps it turns out that you are right, but I want to be satisfied about this, that is all.—Mr. Warnock: Certainly, Mr. Chairman.

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1833. I am taking your first year, that is the position at the beginning of the year?—Correct.

1834. The figures in column 2 are the position at the end of the year?—Correct.

1835. We have to assume, according to your hypothesis, that during the year a profit of £24,000 was earned.—Correct.

1836. Taking it in stages, if a profit of £24,000 is earned during the year, *prima facie* the assets should be £24,000 greater at the end of the year than they were at the beginning?—Mr. Hume: Mr. Chairman, I feel I ought to say this. You have two or three times said that columns 1 and 2 are one at the beginning of the year and one at the end of the year. They are in fact both at the beginning of a year and we are here making an assumption which I think you and I had to make the other day in another place that someone prepared his trading and profit and loss account, balance sheet and so on overnight, paid his dividend, paid his taxes and generally adjusted his situation at a speed, of course, which does not really happen. I think if you will take that into account then you will find that your £24,000, having accrued, is also paid out in considerable measure during that magic night when all these things happen.

1837. But, Mr. Hume, you are anticipating my next question. I am taking it in a simple series of stages in this miraculous evening. We did begin by assuming that during that year £24,000 worth of profits was made and if nothing was paid out of them and nothing had to be paid out of them you would expect to find £24,000 worth of assets more than there were when you began the year, that is right, is it not?—Entirely correct, Mr. Chairman.

1838. Now we cannot proceed on the footing that nothing is payable out of them. What is payable out of the profits, the assets representing the profits? As I understand it there is the taxation amounting to £10,605, is that right?—Mr. Warnock: No, Sir, with all respect it is not.

1839. Is that where we differ?—It is one of the places.—Mr. Hume: It is less actually, £9,900.—Mr. Warnock: The tax paid out is £9,900 made up of the previous year's income tax and the current year's profits tax.

1840. Income tax on last year's profit and profits tax on the current year's profits?—Correct.

1841. £9,900. Will you put that down on a piece of paper?—I have it, Sir.

1842. That means that your assets of £24,000 have been depleted and have now become £14,100, is that right?—I think we are going to get a little involved in a moment in a difference between assets and cash.

1843. I am going to talk about cash separately.—Mr. Hume: That is correct as a mathematical calculation.

1844. I am taking the whole of your assets together.—Mr. Warnock: May I make a point, Sir. In paying out last year's income tax you have not in any way depleted your assets because you had a reserve for it at the end of last year, so that you have not depleted your assets by £9,900. There is this difference which one cannot get over. You I think are dealing in terms of cash rather than in terms of net assets whether they happen to be fixed or current. The two cannot be taken one as the other.—Mr. Hume: It is perfectly true that out of the £24,000 earned as profits somebody has had to draw cheques for £9,900 to pay tax, that is correct as a mathematical statement.

1845. That leaves a net increase in assets of only £14,100, does it not, at that stage?—No, because of the £9,900, £6,000 was provided as a liability at the beginning of the period.

1846. All right, you provided £6,000 in cash for that liability at the beginning of the year?—That is right. During the year you burnt up your whole cash balance in paying tax, that is correct.

1847. In addition to having £6,000 in the bank you made then an extra £24,000?—Yes.

1848. So we will start with £30,000, shall we?—Mr. Warnock: That is better.

1849. Now you have paid £9,900 odd in tax?—Correct.

1850. That reduces you to £20,100. Now you are going to pay out a dividend, £5,000?—Right.

1851. That leaves you with £14,600?—Correct, Sir.

1852. Increase in net assets?—Yes.—Mr. Hume: No.—Mr. Warnock: Increase in cash.

1853. All right, increase in cash; you may have put that into stock?—Yes.

1854. Call it cash if you like.—Mr. Hume: It is cash not net assets with great respect, that is fundamental.—Mr. Warnock: It is not net assets; it might be cash but it probably is not.—Mr. Hume: It is in this example; it is cash, and where has it gone?

1855. I want to know where it has gone, that is what I am after.—£8,000 has been paid away to the man who supplied you with your stock, £4,000 is being lent to the people who owe you money and have not yet paid, £2,600 of it is being lent to you by those who give you credit, so that you are £10,600 down in cash, and if you take that from the figure you have now reached, I am not sure whether it comes to £4,600 or not—

1856. Yes, it comes to £4,600.—That is your cash balance.

1857. Now, I can agree with that, that that comes to that result; but I am still asking on these calculations where have the assets gone which represent the £5,000 out of that £24,000.

1858. Sir Geoffrey Heyworth: You started with £24,000 instead of £19,000?—Mr. Warnock: There is a slight misapprehension. I think the Chairman is omitting the fact that the fixed assets have in fact decreased in value. It is not just a book £5,000 which moves from one side to another. You in fact finish up with machines or buildings, whatever it may be, which are worth £5,000 less than they were at the beginning of the year.

1859. Yes, but that is what I am speaking about. You are treating the annual drops in the value of the plant as if it were an actual cash outgo.—Mr. Hume: We have used up our £20,000 of cash, and we have agreed between the lot of us, have we not, that only £4,600 is left.

1860. Yes, so far.—That is the position of your banking account in the submission we have put before you. I honestly do not think that for the purpose of this argument it is particularly relevant what your balance sheet looks like. Your fixed assets you can maintain at the original £50,000 and set up a reserve against them, or I suppose you can disregard depreciation and put up your employed capital by £5,000 per annum if you can persuade anybody to sign that balance sheet.

1861. Just answer this one further question then perhaps I can satisfy myself about it. Will you assume that this company did not reserve for any depreciation. Now, what would be the figure of retained profit for the first year in such a case?—£7,805.—Mr. Warnock: With consequential amendments in the tax position. There would be a little difficulty with the auditors.—Mr. Hume: It would have an effect—

1862. How would it have an effect?—If it is not allowed as a business expense your profit would be higher—

1863. You are allowed a wear and tear allowance whether you write it off or not.—The so-called retained profit would be £7,805 instead of £2,805. The employed capital would be £157,805 instead of £152,805.

1864. That is what I mean.—That is correct.

1865. Where would that £7,805 appear?—By writing up the first line from £45,000 to £50,000; that gives you your balance.

1866. Mr. Millard Tucker: And the other would remain the same?

1867. Mr. Hicks: But you would not change your cash.

1868. Mr. Millard Tucker: Yes, I see. I think that satisfies me more, but for the moment I was a little puzzled. It may be the way in which I understood the illustration; I did not quite understand it properly. That was really the only thing that was troubling me because what this sets out to prove was that the effect of both of inflation and of the high tax together was to reduce your cash balance. That is what it shows, does it not? What

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I want you to tell me is that your cash could only be improved by reducing your tax liability, could it not, on this hypothesis?—*Mr. Warnock*: Other things being equal, yes.

1869. They are equal because you have assumed it. That is the only thing.—*Or reduced dividends.*

1870. No, taking your own hypothesis.—*Mr. Hume*: I think the only two alternatives, are, of course, to assume that there is no or less inflation, and/or that as you say the tax liability is less or, taking *Mr. Kaldor's* point, that because of the inflation you make more profit; that is a view which I do not personally share.

1871. I gather what you want to show is that a great proportion of the reduction in your cash is due to a wrong system of taxation which takes too much tax altogether. That is what you are trying to show, is it?—I do not think it would be entirely fair to say that. The two forces at work together are the evil. If this company had received in year 1 precisely the same, or, in other words, if you take the inflationary aspect out of this, it would gradually have added £2,000 of cash in each year to its free net resources, and therefore it would be incorrect to say that tax alone sweeps away more cash than the company earns.

1872. It is inflation as well?—Tax is a very high percentage of it, but it is inflation as well. I think in my memorandum I have made that quite clear at the start.

1873. Yes, I know. What I think you want to establish, and what I am trying to help you to do if I can, is that it is this excessive taxation which is also helping in that it is depleting the business of assets which it really requires.—That is the case, Sir.

1874. Now, how do you show in the end, then, that it is entirely due, or is due to a large extent, to the wrong system of charging depreciation allowances for tax purposes?—*Because, Sir, under column 6 there should be £25,000 available to bridge the gap in the depreciation of the fund assets.*

1875. Yes?—And that, as I have emphasised, takes no account of the fact that during all this period the cost of the assets needed to replace those which have depreciated has likewise gone up. If you assume they have doubled, of course you need £50,000 for that purpose and I submit to you that that illustrates in the simplest possible form the evil and the difficulty with which British industry has to contend today. If at the expense of tax the industrialist had in fact been allowed to accumulate £25,000 in cash over that period, he could only then say that £25,000 is inadequate bearing in mind the change of values that has taken place in the meantime. But today he is not only faced with that problem but the cash which the Revenue allows him to accumulate is, in fact, not there.

1876. That is right, *Mr. Hume*. In our first committee we said the reason for that is because too much tax is being taken out of business; in other words the dominant partner is claiming too large a share of the profits and taking it out in the form of cash and spending it.—Nobody agrees with that more than I do.

1877. That was the conclusion, you remember, at which the first committee arrived. Now that conclusion is being assailed on the ground that that is not the real complaint. The real complaint is that the tax is too high not because the rate is too high but because you have calculated the profits on a wrong basis.—I think that is a valid argument, but am I not right in saying, I am no economist, that that argument would not in fact arise if there were no inflation? It is true that nobody would be able to retain enough profits to meet the contingencies for which wear and tear do not provide but, on the assumption that wear and tear is in fact adequate provision for replacement of assets, there is no gain saying the fact that if you eliminate the inflationary trend out of this or any other set of figures there would in fact be enough cash to keep the business on a level keel.

1878. Do you say that in ascertaining a year's profits you must allow for the wastage of capital that has taken place during that year?—Yes.

1879. I think everybody is agreed with that as a principle. Now, what is the capital which is wasted? Is it what you paid for the asset originally or is it the current value basis?—The current value, I think, on that simple

question. If a man bought a machine for £100 and has to replace it with a precisely similar machine which costs him £200, it is the current value which he must be able to recover.

1880. *Mr. Hicks*: Might I be allowed to ask a question which I think might help to elucidate the position? *Mr. Hume* has been telling us that there are two factors making for this lack of cash in conditions of inflation, one being the taxation factor and the other being what he calls the inflation itself. Now we have heard a good deal about the taxation factor from other witnesses and it is obviously that which is our main concern, but the emphasis which *Mr. Hume* has been laying on the effect of the inflation itself is, I think, a thing which we want to clear up and get quite clearly in our minds this morning. I would like to suggest we can understand that very clearly if we take an example, not a hypothetical one but a perfectly real one which happens to be very clear of all the other complications, something not liable to taxation and which is not even affected by dividend policy or anything of that sort, and that is a case which is real to us on the academic side, but not in our academic capacity, namely the business of looking after supplies of wine to a college. This is a thing which is very commonly experienced. A college sets up a wine fund, a non-profit making concern. So much money is advanced by the college to the wine fund and effectively the wine is sold by the fund to the college at a price which is just developed to cover cost. When conditions of inflation develop in fact it is extremely difficult to put up the prices at which the wine is sold to the college fast enough to prevent a shortage of cash of precisely this kind developing in the fund. In fact the prices ought to be put up so as to provide a sufficient amount of money to replace the stocks at once which are being exhausted, but in actual fact that does not get done, at least it very rarely gets done. Economists in colleges sometimes try and persuade their colleagues to put up prices more rapidly in order to meet this situation. We find it very difficult to persuade our colleagues to do so. I think economists are always a little inclined to think business men are very wise people, not so stupid as we find our colleagues to be. I am afraid that what *Mr. Hume* and *Mr. Warnock* are telling us is that business men do in fact behave as we notice our colleagues behave.

1881. *Mr. Greenwood*: But your assets are increasing all the time if you do not drink them. They are not quite the same, are they? If you did not drink your assets the value would be going up all the time. You really ought to be taxed on your perquisites. You really are getting something not in your salary.

1882. *Mr. Hicks*: We are paying for what we get.—The increased capital sunk in your wine cellar would not come about if it were not a fact that it was turning over and selling all the time. I agree with you as a business man that it looks as if your colleagues have not put the price up quickly enough or calculated the continuing rise in the cost. If we do get a setback in prices, a devaluation, the money which you have borrowed to finance your more expensive stock will come free again, that is a natural corollary. Let us examine one further detail. I do not know what is the reason why you do not put up the price to the students. Is it that you have a thought for their pockets or you are not clever enough to set the rise coming? In the example we lay before you it is the incidence of competition. We cannot put prices up because the stuff will not sell if you do. That, of course, is now beginning to manifest itself in the textile trade pretty clearly and . . .

1883. *Mr. Hicks*: It causes inflation if there is too much demand for goods.

1884. *Mr. Woodcock*: None of these things is in your statement; you cannot assume on the one hand that the prices you pay are going up and on the other that the prices you receive are not.—With respect, *Mr. Woodcock*, our prices are going up. Our turnover rises from £240,000 to £351,000 for the same volume of goods. The margin of profit remains constant. As a percentage the actual amount of cash profit rises likewise. I do not think there is a fault in our calculation. You cannot make more than 10 per cent. margin of profit on your turnover.

1885. *Mr. Woodcock*: Not more than 10 per cent?—That is our assumption. That is the point where competition begins to bear

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1886. *Mr. Kaldor*: If you say you have a 10 per cent. margin of profit on turnover, would not the amount of profit actually earned during a year of rising prices be more than 10 per cent. of the turnover? If you charge a profit of 10 per cent. on everything that you sell your actual profit over the year would be more than 10 per cent. of the turnover?—We have tried to give the answer. We could agree with you if the inflationary rise was not even throughout the period, if in certain years it advanced rapidly and others less rapidly, then I think your point has much more validity than in our example where we have taken a level movement right through, and I think the statistical figures lend us some support.—*Mr. Warnock*: I would like to add a word on that. I think that Mr. Kaldor might see it more clearly if he differentiated in his mind between the normal accounting form of profit and loss account of which we have tried to prepare examples, and the manufacturer's cost estimate, whatever you like to call it. I think I am right in saying that many, if not most, industrial managers now prepare their estimates of the figures at which they can afford to sell their products incorporating materials at replacement cost; on the grounds that they have, when they sell the product, immediately to replace the materials concerned at the price then ruling. But these cost estimates which you are thinking of all the time do not correspond to the figures used in preparing a normal profit and loss account such as will be signed by an auditor. We are saying there should be a closer relationship between these two. We agree with you there, but this does not happen at the moment.

1887. *Mr. Carrington*: Mr. Hume, I want to ascertain or get you to agree, if possible, how much of this deficiency, cash deficiency, in your hypothetical case arises from inflation and how much from taxation. I make it that the stocks over the period covered by your example have gone up by £48,841 in terms of money, whereas the volume has remained constant. The debtors have gone up by £24,000, so those two figures together come to £73,261. The creditors have increased by £12,210 and deducting that from the £73,261 we get a figure of £61,051. Would you agree that that is the amount of cash resources required to finance the inflationary position so far as concerns current assets?—Yes, I think there is no doubt about that.—*Mr. Warnock*: I think it is stated in the memorandum.

1888. Whereas over this period this company on your hypothesis has paid or is due to pay in respect of taxes referable to this period £66,000?—Agreed.

1889. Even if there had been no taxation.—*Mr. Hume*: No inflation?

1890. No, no taxation at all. If there had been no taxation this company would only have had something slightly over £5,000 towards the cost of replacing its fixed assets.

1891. *Mr. Greenwood*: You are presuming you are making a bigger profit each year?

1892. *Mr. Carrington*: No. Will you let me continue, if you do not mind.—That is, I think, mathematically correct.

1893. Your inflation has soaked away £61,000 so far as floating assets are concerned. Taxation has taken £66,000?—Agreed.

1894. If you had had no taxation you would have had £5,000 more cash in the business?—All the other figures being equal.

1895. All the other things being equal, and you have paid by way of dividends £27,500?—Right.

1896. So that even if you had paid no dividend and if you had paid no taxation you would still have been in a difficulty.—Yes. You would not have had the £25,000 of wear and tear in cash except to the extent of the £5,000 you mention. Beg pardon, the dividend as well.

1897. Assume you had paid no dividend.—Very well. By paying no tax you save up very nearly £6,000. By paying no dividend you do not pay away another £27,500. That is £33,500 you would have had at that point of time.

1898. And that is less than the depreciation calculated on replacement cost assuming the replacement cost would be doubled?—Precisely.—*Mr. Warnock*: Might I ask a question? Did you postulate that inflation continued and no tax was payable?

1899. Yes. I am assuming for the purpose of getting at this position the inflationary position as reflected here.—May I just clear one point. I understood you to say that under these conditions you would have sunk £61,000 in extra floating assets, but that you would not have paid out £66,868, subject to a small adjustment, in cash?

1900. Yes.—Surely you would be £66,868 better off in cash?

1901. If you paid no tax. Is that not just about the figure required to... Yes, agreed.

1902. What I am trying to get at is that there are two factors here which on this example are relatively the same. Let us look at this question of the effect of inflation in regard to the stock and the profit arising. If these stocks throughout had been valued on a base stock basis, the closing stock figure would have been not £128,000 but £80,000, would it not?—*Mr. Hume*: £80,000, yes.

1903. And the tax would have been less by tax on £48,000, in other words £24,000?—Yes.

1904. So is it fair for us to assume from your example that £24,000 of this £66,000 tax represents tax on the inflationary profit on your stock?—*Mr. Warnock*: That is so, and I think we state it in so many words, do we not, in the memorandum. I think it is paragraph 8, item c:—

"Of the total taxation charged (£66,868) £24,664 rises from the inflationary increase (from £80,000 to £128,000) is the cost of an unchanged physical volume of stock."

1905. My point is really this: if stocks had been valued on a base stock basis, this company would have been better off to the extent of £24,000?—Yes, certainly.

1906. And that would have been possible under the basis which is available to taxpayers in the United States?—We can only say "so we understand." I personally am not conversant with United States procedure.

1907. Turning right to the end of your memorandum, Mr. Hume, the very last sentence, would you elaborate the phrase "appropriate cases"? It is a nice round phrase but it is difficult to get a meaning from it. You say:—

"Believing as I do that the problem is vital and urgent, I therefore see no alternative but to tackle it immediately by redoxing in appropriate cases the effective weight of company taxation."

Had you in mind some differential basis as between one type of company and another?—*Mr. Hume*: There are, of course, companies which hold little or no stock, a bank or an insurance company. I think we might have made the memorandum just as effective by leaving that out. There is no deep significance in those words, Mr. Carrington.

1908. I was wondering whether there was any significance?—No.

1909. Or any thought of what was said in the Report of the first Tucker Committee about a differential rate of initial allowance according to the...—No.

1910. *Sir Geoffrey Heyworth*: I have just one general point. From your experience at the present time would you say that in what has actually occurred in the history of companies with which you have contact, the main trouble so far has arisen through higher prices for current assets rather than fixed assets?—The main trouble? I think the answer would be yes, but of course the financing of fixed assets in cases where people have been able to buy or build is just as strong and just as aggravating as financing the current assets. By and large I should have thought that in the last five years the additions to fixed assets in the generality of companies was comparatively small by reason of the difficulty of obtaining those fixed assets or building leases or whatever it may be. I can cite a company of which I am chairman where we have had to build fixed assets, a question of putting in storage to meet changing conditions in agriculture in this country, and there the cost of these additional fixed assets has been just as embarrassing as financing the additional cost of current assets.

1911. When it comes to the financing of the shortages as they occur so to speak in cash resources, would you expect that if the fixed asset problem gradually emerges it would be much more difficult by reason of the fact that the bank would be much less willing to increase as

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overdraft if the need for it arises out of fixed capital?—It is supposed to be a basic conception of banking that their resources are not available to finance fixed assets, and if at the moment you try to persuade your bank to finance fixed assets you have to get Capital Issues Committee's consent because it comes into that category; and there is in my opinion the far stronger psychological argument that the average Englishman does not like to be in an over-borrowed position without being able to see quite how he is going to get out of it, with all the inhibitions that go with it in freedom to trade and taking risks and so forth.

1912. You would therefore expect that as the replacement of fixed capital becomes necessary there will be real difficulties in finding the money to get it done?—I go so far as to say, I think the trouble has hardly begun yet.

1913. *Sir Geoffrey Hysworth*: I think that is all I want to ask, thank you.

1914. *Mr. Crick*: I wonder if I might take you out of the field of accountancy and just the field of economics and, heaven help us, into the field of law? I want to refer you to paragraph 5 of your memorandum where you make a statement of intent—"Wear and Tear allowances are intended to provide for the replacement of plant". Now the context suggests that that intention is alleged to have been held by the authorities responsible for making the allowances. Interpreted in that way would you be prepared to sustain that sentence or would you rather not say that they are intended to recover the cost of the fixed assets?—I suppose they are intended to recover the cost of the fixed assets and the negotiations with the Revenue which have fixed the rates for depreciation and wear and tear were, I think, carried on, certainly before the war, without any price rise in mind, so that the original cost and the cost of replacement were the same thing at that time. It is only today that this point has arisen.

1915. I wanted the distinction clear because we heard some very interesting remarks yesterday from Sir William Coates in his interpretation of the intent of Parliament when it introduced this wear and tear allowance as long ago as 1878. Now I do not want to take you unwares in any way, but I want to read, if I may, what the law said in 1878, and then I want to ask you whether you would feel that, if that provision had been carried out reasonably, faithfully and in the spirit of the legislature right through these years since 1878, the difficulties of which you speak would have been largely avoided. That will be my question but I should like to read the passage. It provides that:—

"The Commissioners when assessing the profits under Schedule D shall allow such deductions as they may think just and reasonable as representing the diminished value by reason of wear and tear during the year of any plant and machinery used for the purposes of the concern."

Now would you feel on a first hearing that a liberal, shall we say, application of that rule and interpretation of the spirit of Parliamentary intent would get over your difficulties?—"Diminished value." I think are the material words there.

1916. The diminished value?—I think it is fair to interpret the spirit behind those words as meaning that in fact you are accumulating enough money to replace the asset in time at the appropriate time. I would agree with you, Mr. Crick, as far as I understand the English language that that is a very fair interpretation of what those words mean.

1917. I wanted to get your view on whether you felt that really the original intent had been something that would have met your difficulty to some extent, at any rate so far as the difficulty arises with taxation. In paragraph 14, Mr. Hume, you speak about one consequence of all this as being the necessity for the introduction from outside sources of fresh capital, which you consider to be objectionable. Now would you say that there has also been a trend within that movement towards larger institutional investment in recent years?—Yes, there is no doubt about that. The reason may not be precisely the one we have been discussing up to date, but the private capitalist is gradually disappearing as a force in the investment field. In fact the only substantial sources of new

investment today are, I think, those organisations and institutions which collect the savings of small people in small amounts, aggregate them up into large amounts and feed themselves free to use a proportion of this aggregated amount in industrial capital and even, to a lesser extent of course, in venture capital. The reason is that personal taxation is wiping out the private investor.

1918. So that you have the squeeze from both sides; on the one side profits taxation, on the other side personal taxation?—That is what we, as a house of issue, view as a very grave difficulty ahead.

1919. Would you regard the increasing reliance on institutional investment as something to be deplored on the whole?—To the extent that the institutions are prepared to provide venture capital, I have no reason to suggest that is any less desirable capital than capital flowing from a large number of private individuals; but to the extent that the institutions by their very charter and basis of trade normally have to place a high proportion of their capital in safe investments, the flow of venture capital is, *pro tanto*, dried up to the great disadvantage of British industry.

1920. So far as your last sentence is concerned, Mr. Hume, are there any very definite and specific suggestions you would offer?—I think that the tax which bears most heavily on industry today, and is regarded as seeping away resources which they ought to be allowed to keep, is the profits tax. It is a counsel of perfection to say lower the rate of income tax too, but I do not think that is really so practicable as reducing profits tax which is a discriminatory tax levied against people who are taking the risk and making the running in the trade of this country. It is objectionable and a severe brake on growth and development.

1921. So that you would put in as priority number 1 the removal of profits tax?—That is so.

1922. Supposing that were impossible, would you see any advantage in applying the profits tax at a level rate rather than the differential rates?—I see no particular advantage and certainly a disadvantage if it meant that the tax on retained profits went up. If the tax on distributed profits could be brought down to or nearer to the existing retained profits, one would of course welcome it. It would facilitate this very difficulty of raising venture capital; but I should deplore any re-arrangement of profits tax which bore more severely on retained profits than the present one.

1923. Supposing you could get rid of profits tax at the cost of increasing the personal income tax, would that not dry up still further the flow of available capital?—I think it might, from private individuals you are meaning?

1924. Yes.—I think it might, but of course there are other taxes, stamp, death duties, which play a considerable part in this availability of capital from the private individual.

1925. *Mr. Keldor*: I am sorry to have to hark back on this hypothetical example but it is because I find it so fascinating. Can I ask Mr. Warnock a few questions on the meaning of these figures? The year 1 in your example can be taken as the operations in a year, Mr. Warnock, where no inflation takes place or, in other words . . . —*Mr. Warnock*: Mr. Hicks does not entirely agree with you there but it is substantially so.

1926. That was your intention, so if there had been no inflation successive years would have been a repetition of the same figures, as far as your intention is concerned, as are given here for year 1?—Yes.

1927. Turnover £240,000; that means sales in the year?—Yes.

1928. And that means also that in that year £216,000 was spent on the purchase of goods?—No, it does not. We are coming back to this point again where you are forgetting the difference between replacement cost of the year and the "usage" cost, which is based, at least in part, on an earlier cost represented in opening stocks. If you take the simplest example, I find it difficult to follow figures through in my head, suppose you are a metal merchant and that just before the end of one of your financial years you buy 100 tons of metal at £1 a ton, you have that in stock at the beginning of the next year, £100. Suppose

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that during the year you sell that 100 tons for £3 a ton and that the only other thing you do during that year is to replace your stock and that you pay for your replacement at £3 a ton, which is not unlikely in an inflationary period; it is not impossible, it happens every day as far as industry is concerned. When you have drawn up your profit and loss account, and it has been signed by your auditors, it will show a profit of £200 for the year. You do agree that? Let me finish first, sales £300, cost of sales £100, stock £300, and you will pay tax at whatever the rate may be on this profit of £200; so that if you care to think of the difference between your position as a metal trader at the beginning and at the end of this year, in the first case you had 100 tons of metal and in the second case you have 100 tons of metal and a liability for tax. It is true the 100 tons of metal with which you finish is of more value to you if you can dispose of it and get out of business, and that one in the particular case he set off against the tax liability we have talked about. Industry is not in that happy position. . . .

1929. I am not talking at all about what happens to industry; I am trying to elucidate your figures and asking you some perfectly simple questions. . . .—They may sound simple to you. I am having difficulty in understanding them.

1930. Supposing there were no inflation to your hypothetical company, you then said that year after year the same figures would be valid as those here shown for year 1, is that correct?—Yes.

1931. After all you are comparing here two situations, one in which there is inflation and the other in which there is no inflation. If you go on to the next stage you then show what would have happened if there had been no inflation?—Agreed.

1932. I am asking you, if there is no inflation and these figures represent the annual situation of that company, assuming no changes, in that case £240,000 represents the value of sales?—Yes.

1933. Am I correct in supposing, there is no figure shown here, that in that case £216,000 would represent annual purchases of goods? Is that correct?—No, I am afraid it is not.

1934. Can you give me the figure?—No, I cannot.

1935. Why not?—It will in fact be substantially higher. You keep on coming back to the same point. . . .

1936. The figure actually received from the sale of goods is £240,000. What is the amount actually spent by the firm on purchasing goods, assuming it maintains a constant stock and buys goods at a regular rate? I am merely asking what would be the figure in the absence of inflation?—In the absence of inflation?

1937. Yes. It seems to me that from your example the figure is £216,000; if it is not. . . .—Mr. Hume: £240,000 is a combination of raw materials, direct wages, rents, overheads and everything else. Why pick on. . . .—Mr. Warnock: I think Mr. Kaldor is taking the difference between £240,000 and £24,000.—Mr. Hume: The cost of purchases consumed is £216,000, yes.

The proceedings were adjourned accordingly.

On resumption.

1949. Mr. Kaldor: Mr. Chairman, might I repeat again the point at which we left off before lunch. In your assumptions, Mr. Hume, you assume that the real volume of sales is unchanged year after year, and the money value of sales increases by 10 per cent. per annum because prices increase by 10 per cent. per annum. Is that correct?—Mr. Hume: Yes.

1950. I said that it is implicit in your example that in the first year £216,000 was spent on purchases, that includes materials, wages, or any other expense. That must be so because £216,000 plus £24,000 makes £240,000, the value of sales, that is correct, is it?—Quite.—Mr. Warnock: Except for the word "spent".—Mr. Hume: Mathematically correct.

1951. Would it be correct to suggest that in the second year it is implicit in your figures that these purchases or expenses, if you like to call them that, have gone up from £216,000 to £245,000. That is implicit in your figures, is that correct?—Mr. Warnock: I have not followed your calculations.

1952. I was trying to abstract, for the sake of simplicity from any other costs, I agree that is a simplification.—Something which has no rent?

1953. The rent and everything else comes out of its gross profit. It comes out of this £240,000. Let us make an assumption, you see?—Go on.

1954. In that case it would be £216,000, am I right in saying?—Mr. Warnock: Subject to all the qualifications you have made, yes.

1961. What is the meaning of all these qualifications, otherwise you would say that £216,000 represents the cost of production of the goods in question, that is to say the amount spent on materials, the amount spent on wages, fuel and everything else. One of the two, I do not mind which you choose, but it does represent something?—Yes, it represents the cost of materials, time, labour, and everything else, under present accounting concepts which we think to be inadequate in an inflationary period.

1962. I am not talking about inflation for the moment.—Right.

1963. You are saying here in assumption No. 4, monetary inflation takes place constantly throughout the five years at the rate of 10 per cent. per annum. Does that mean, Mr. Warnock, that you assume everything increases in price by 10 per cent. from one year to the next?—Yes.

1964. Everything?—Yes, excepting only the unchangeable costs such as depreciation or wear and tear.

1965. That means that that company after a year of inflation will have spent instead of £216,000, £237,600, that is exactly 10 per cent. more? Its outlay will have gone up by 10 per cent., that is your assumption, so it follows that if you start with £216,000 it goes up to £237,600?—I accept your figures: I have not worked them out. It obviously must be so.

1966. And your sales go up also by 10 per cent. from £240,000 to £264,000, right? Now, Mr. Warnock, does it not follow from this, and this is the crux of the question I am getting at, that if the firm spends 10 per cent. more, £237,600 instead of £216,000, it ends up with a stock at the end of the year which will be £8,000 more? It ends up at the end of the year with a stock valued at £28,000 instead of £20,000.—That is so; it is stated in the Table.

1967. Then does it not follow that that firm will have received in that year £26,000, being the difference between £264,000 received and £237,600 spent in addition to an increase in its stock value of £8,000?—No, I do not think it does.

1968. That is what I would like to get clear, is what way it does not and why not? Obviously you are assuming something else. I am merely trying to get out the assumptions behind your hypothetical example. Something is wrong because it follows from the figures, if you agree with them, that that would be so.

Mr. Milford Tucker: That would be a very convenient time, I think, Mr. Warnock, if you would think over that question over lunch.—Thank you, Sir.

1952. Perhaps I could repeat the calculations as to how this figure was reached. The value of your sales was £264,000 and added up with stocks equal to £28,000. . . .—Mr. Hume: £237,600 is the figure.

1953. £237,600.—Keep deducting profits from the turnover, that is the figure you are after.

1954. I want to ask what is implicit in your figures of the annual expenditure of this hypothetical company, and you say it is £237,600.—To the extent that your turnover is profit you do not spend it on anything else so it is line 1 minus line 2.

1955. I put it to you that your profit in the second year is not £26,000 but £35,000, this is where the error occurs.—Mr. Warnock: I think I see what the difficulty is.—One of the assumptions that we have made is that on a flat rate of physical turnover from year to year, the selling prices go up by 10 per cent. from year to year, that is clear, and there is no difference between us, I think. The concept that we are trying to express from that is that the industrialist will so fix his prices that he will endeavour to keep his actual net rate of profit, subject

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perhaps to depreciation, to the same percentage figure on his £ s. d. turnover from year to year. In order to do that to the best of his ability he will prepare his costings, or estimates of costs, or whatever you like to call them, taking in materials, that is the easiest item, at their replacement price at the moment the costing is prepared; let us presume it is the same moment as the goods go into production, and he prepares his selling price to show a yield, expressed in normal accounting concepts, of 10 per cent. net subject to depreciation. However, these goods take a certain time to go through his factory, and the time, it is the time factor you are leaving out of account, the time is some four months. If you care to examine the assumption closely it is a little over four months, but we stated it as four months. In that four months, as I see it, his materials and replacement costs rise by another 10 per cent. per annum, so that instead of earning a profit of 10 per cent. without qualification, in fact he earns a profit on his turnover of 10 per cent. less 3 per cent. which has disappeared, remembering that he is working on replacement costs, owing to the rise in replacement prices of stock in the intervening four months. Therefore his economic profit, I am moving a little into your field which I should not because I am not qualified to do so, his "economic" profit there is 7 per cent. On the other hand, there is this stock appreciation which is an exact balance of what is lost by this lapse of time and the balance is 3 per cent.; so that by natural processes of arithmetic, as I see it, he comes back to his profit figure of 10 per cent. on turnover. But I agree with you that 7 per cent. of it is the true economic profit which you are talking about and 3 per cent. of it is the increased value of the same physical stock. I am sorry if I cannot get past that point, but that is how I see it. It may be that in assumption 5 we have condensed the phrasing unduly. I think now that we have to widen the assumption. It says:—

"That selling prices and all costs except depreciation rise hand in hand with monetary inflation, so that the ratio of profit before depreciation to turnover remains constant—at 10 per cent. per annum."

One could qualify it up hill and down dale and explain it, but I think the word "so" would be better replaced by the word "and". It is not, I submit, the common experience of industry that you can keep on blowing up profit percentage figures, on already inflated sales figures, as a result of inflation. I think there are better judges of that round this room than I, but I think that your industrialist is happy to maintain the same net profit per cent. on turnover, the calculation being in normal accounting concepts.

1956. I am very grateful to you for all this explanation, but I have asked you some very simple questions which I am afraid you have not answered. The simple question was what is the basis of the figures given in this Appendix A. You referred to all sorts of things, what the industrialist can in reality do or not do, and what I am attempting to do is to try and understand your figures. I am not going into the question of whether they are a correct representation of what really happens, that is another matter. I am merely trying to understand what you put forward, and what I suggest is this. Is it correct to say that in the year 1 £240,000 represents the sales and £216,000 the purchases of that firm. In the year 2 £284,000 represents the sales and in order that the profit earned should be £26,400 the corresponding expense item must be £245,000 odd, that is my point. In order that this £26,400 be the profit on the turnover of £264,000 it is necessary that in that year the firm should have spent on purchases £245,000 instead of £250,000, do you agree?—Mr. Hume: I am sorry, I do not get the £245,000, £264,000 minus £26,400 is £237,600, unless my arithmetic is at fault.

1957. If you make the expenses £237,600 then you have to credit the difference between your opening stock and your closing stock.—Mr. Warnock: We seem to be in two different worlds, but the thought that we are trying to express very simply is that in the first year, taking Mr. Kaldor's supporting point, we have receipts or "receivables" of £240,000 and outgoing or "outgoings" of £216,000, and a profit of £24,000. It seems inescapable to me that if all costs rise by 10 per cent. you increase each of these figures by 10 per cent., and therefore the difference between them by 10 per cent. I do not know whether that is an elementary arithmetical error, but it seems straightforward and clear to me.

1958. I am sorry to disagree with you, but if you do increase both your purchases and sales by 10 per cent. from the base year your profits increase more than 10 per cent.—Consumption, not purchases.

1959. I am thinking of it simply in terms of a firm's accounting. On one side of the balance sheet they have, as it were, money received for sales and on the other side of the balance sheet for the same period there is money laid out on purchases. There is no question of prices, it is merely a method of accounting. I suggest to you that from an accounting point of view your example here is wrong, the figures are wrong unless you make one or two assumptions, unless you assume that your purchases annually increase by more than 10 per cent. or your profits increase by more than 10 per cent. It is not possible from the hypothesis that you make in this example to derive these results if you assume that the purchases and sales both increase by 10 per cent. This is the point I put to you but, Mr. Chairman, I do not want to press this point. This example has already held us up for a very long time, and I do not want to spend too much time on it—I would be reluctant, Mr. Chairman, to leave it precisely at that point. I think we are getting involved between purchases, using the word strictly, and consumption. It is consumption that is the debit to the profit and loss account. If I may just give you one very simple case which, as I see it, is exactly what Mr. Kaldor is thinking of. Let us forget those large figures, and say that we have a concern that sells in one year £200. Consumption, that includes more than purchases, consumption of goods and services £100, profit £100. Let us increase the sales figure by 10 per cent. making it £220, and the consumption figure, as I see it, goes up in exactly the same way by 10 per cent. to £110. The profit I think, unless my arithmetic is very wrong, also goes up to £110 which is an increase of 10 per cent. I just cannot get past that point.

1960. Mr. Carrington: May I help to clear this point? Would you mind telling me for the second year what is your debt for consumption, that is goods used plus wages, etc.—Your trading account year 2, £237,600.

1961. That is the year when the turnover is £264,000.—£237,600.

1962. May I just take up a minute by running through the account for that year on the hypothesis. Let us take the credit side, sales £264,000, closing stock £18,000.—Closing stock £96,800, I should have said.

1963. All right, take it at £96,800.—That is right, is it not?

1964. I do not mind whether it is £18,000 or £96,800 because it is a general reflex on the opening stock. Take the closing stock £96,800 and the opening stock is going to be £18,000 is it not?—Yes.

1965. Total credit side is going to be £360,800, is it not?—Right.

1966. Take your debit side, opening stock £18,000?—Yes.

1967. You say your profit is £26,400. I am leaving a blank for the moment, would you mind filling in that blank figure for your purchases? I make it £246,400.—Mr. Hume: So do I.

1968. What Mr. Kaldor is trying to get at, I think, is the relation between the figures you gave me as the expenses plus purchases for the year, £237,600, and this figure that we have arrived at together of £246,400.—Mr. Warnock: Could we take the previous year as well, or the year after?—Mr. Hume: Take year 3, £264,000 becomes £290,400, does it not? The £96,800 becomes £106,480, is that right? The opening stock is £96,800 and the profit for the year is £29,040.—Mr. Warnock: I think you will find that the first year's figures we talked about was £246,400, that is the purchases for year 2, and the purchases for the second year we are discussing, that is, year 3, are £271,040, which is an increase of 10 per cent.

1969. Mr. Kaldor: May I have all those figures? What is the opening stock, £96,800?—Mr. Hume: Mr. Carrington is seeking to write the trading account.

1970. Mr. Carrington: All I am doing is trying to clear the difference, or reconcile it.—Mr. Hume: We have taken years 2 and 3 for the sake of this example. Year 2, the left-hand side of the trading account is opening stock £18,000, purchases and other expenses £246,400. Profit

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£26,400 as stated. Totalling £360,800. The credit side of the trading account is £264,000 sales, £96,800 closing stock, again a total of £360,800. Year 3, opening stock £96,800, purchases and other expenses incurred in the year £271,040. Final profit as stated in my memorandum £29,040. Total debit £306,880. Credit, £390,400 sales as stated, £106,400 closing stock as stated, total £396,880. Purchases and other expenses in year 2 were £246,400 and in year 3 £271,040. £246,400 plus 10 per cent of £246,600 is £271,000 as near as can be.

1971. Mr. Kaldor: I agree with you, but my proposition was that in your example this does not work. It works between one year of inflation and the next year of inflation, but it does not work as between the beginning year when there was no inflation and an inflationary year.—We have got on to another basis. We postulated before we started this that the inflation was an even percentage rise through the piece. Now you want to change that hypothesis and say it is not.

1972. Mr. Carrington: I think you will find the trouble is in your second year. I am quite satisfied myself that your third year figures are right.—All right. What would you like to do, put an extra amount on the second year's profit, pay more dividend? It does not alter the basis of the whole argument.

1973. I was trying to help Mr. Kaldor's difficulty, and it seems to arise on that second year. The third year is right.—Mr. Warnock: It does not affect the size of the figures we are talking about, does it, or the principle?—Mr. Hume: I still ask you, Mr. Chairman, to be so kind as to allow your fellow members to look at the practical examples which go at the back of this theoretical example where, although, of course, you cannot reduce them to Mr. Kaldor's method of calculation, you can see that the rate of profit earned before depreciation, expressed as a percentage on turnover, is tending to fall. I can assure you from personal knowledge that these businesses are well and actively managed. The management are not giving away the products at a price lower than that which they could get and they are engaged in the ordinary rough and tumble of daily trade.

1974. Mr. Kaldor: Would you say that it is a typical effect of inflation that the rate of profit to turnover drops?—We have tried to choose these examples not to drive home any particular point but because they happen to be among the companies with which we are connected and where the figures are less distorted, for instance as result of the introduction of additional capital or amalgamation or something of that kind. Therefore they are a fair example of what we are trying to illustrate.

1975. Would it be true to say that if it was true generally the share of profit in the national income would fall in successive years? If the share of profits in turnover falls then if this is a typical situation it would manifest itself in the fall in the share of profit in national income.—I cannot answer that, because I do not know how these figures are connected.—Mr. Warnock: I do not see why it should unless the figures other than company profits do in fact rise or fall exactly *pro rata*. Unless that condition is satisfied I do not see that you can draw any conclusion either from variations or principles. I do not see that there is any necessary correlation.

1976. I just do not know how the one could rise and the other could fall, or vice versa. If the share of profit in the selling value falls, if you integrate whole industries, and double accounting is eliminated, that would mean also that the share of profit in the net national production falls, does it not? The one is an implication of the other. I do not want to hold you up on this or tie you down.—Mr. Hume: I must ask that we are not pressed on this point. We do not know enough about it and I hope Mr. Kaldor will have economists here in front of him one day of whom he can ask these questions.

1977. Mr. Kaldor: I must apologise, Mr. Chairman, for having taken up so much time on this.

1978. Mr. Woodcock: The two essential points in your memorandum, Mr. Hume, seem to me to be at the end of paragraph 14 where you say that the whole of your evidence is to the effect that while retainable profits, and you quote the word "profits", in the accepted sense rise with inflation, they do not and cannot rise fast enough to provide for the maintenance of the fixed and current assets. That is the essence of your memorandum?—That is right.

1979. And at the end of the memorandum as a whole, that is at the end of paragraph 15, you say that the problem is vital and you see no alternative but to tackle it immediately by reducing in appropriate cases the effective weight of company taxation. Let us take those statements as being a suggestion. They do not take in a great deal further. Have you any suggestion as to how we should deal with this evil and can you be more specific about tackling it immediately by reducing the effective weight of company taxation? May I put it in another way? Have you said the report of the Tucker Committee on the Taxation of Trading Profits?—I have not memorised it.

1980. You have probably seen in the Report, and of course there will be much more in the evidence, that a lot of people have put forward suggestions of different kinds for dealing with this problem with which you are concerned, but you have not put forward any proposals.—I accept that as a very valid criticism of the evidence which we have given. If you want me to put forward a proposal, Mr. Woodcock, I am bound to say it falls outside your terms of reference, for it is that the total weight of taxation is unbearably heavy. Rather than in maintaining the present volume of taxation, it is in reducing the things upon which taxation has to be spent; and in that connection I cannot do more than subscribe wholeheartedly to what your previous and much more knowledgeable witnesses, Mr. Chambers and Mr. Bower, have said to you on that subject. I am only contented with this point of view, I cannot believe that you have asked me before you for any other reason than that I have had thirty years of practical experience in consulting the savings of the people into productive industry in this country to enable it to thrive and grow and compete in world markets. With the weight of taxation as it is today I am gravely apprehensive that that will not happen in the years to come. The weight of taxation is so high that it is a disincentive to use the savings of the people in the fertilisation of industry and in the maintenance of the standard of life of the 50 million people who live on this island.

1981. For the moment I want to assume that, whether we would ultimately agree with it or not, and ask you if you have given any consideration to what could be done about it. I asked you if you had looked at the Report of the Tucker Committee, and I was really wondering what you thought of the various schemes that have been put forward there. Would you, for example, think that it would be right and practicable to allow relief of all funds spent on equipment or put to reserve for equipment?—I think there is a very strong case for entirely recasting the basis of depreciation which is perhaps saying the same thing in another way.

1982. Not quite, because I want to know the kind of recasting you have in mind.—The adoption of replacement cost against historical cost which has been so much argued.

1983. What do you think of that?—I think the idea is right. The application of it, of course, is fraught with a great deal of difficulty. The practical problem is very great, but unless, and I am bound to be rather negative here, unless the industry of this country can, in fact, replace its plant, on, in fact, go on competing in world markets, it seems to me that it is no good arguing about the fine points of taxation. We are just out as a nation.

1984. Supposing I were to say to you, could it be proved that the statement you have made is not universally true, that indeed some industries or some undertakings with industries are quite able to carry on?—For the time being they appear to be from their public statements which are appearing now. Sir Geoffrey Heyworth asked me a pertinent question. One must not forget the point of modernising and replacing their capital assets.

1985. Let us do what you do, take a hypothesis and see if that is the case. Let us assume that it is the case that there are some industries that are perfectly all right, and some undertakings within industries that are perfectly all right. How would you deal with that situation? Would you think that they were entitled to make a general rule governing all cases?—I think, Mr. Woodcock, it is very difficult to discriminate; to say that because a man has the wit, intelligence and application to have a successful business which can make the grade despite the difficulties should have some discriminatory taxation.

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levelled against him as opposed to the man who is unable to make the grade. I venture to suggest without being able to support what I say by statistics, that the majority of traders in this country are in the second category, unable to make the grade.

1995. Supposing what you say is right, is there any reason in your mind why you should relieve the business men of taxation and still maintain it on other people, private individuals, when both are affected by influences?—You said business men, I would like to say business.

1997. Say company profits then, as distinct from business men—I protest against the use of the word "profits" in this context. "Profits" have come to carry a meaning in the mind of the average man which is not applicable to the balance at the bottom left hand corner of the ordinary company profit and loss account today. I do not think that I could argue that there is any ground for increasing distributable profits substantially beyond the present level, although it be the fact that the man who has ventured his capital and relies upon the dividend thereon has had less of a cut out of the cake than the man who has employed his capital in the shape of his brains or his physical strength. Despite that if Mr. Woodcock is trying to get me to say that I favour increased company profits for the increased dividends that that will bring.

1998. No.—I am not agreeing.

1999. No.—But if he says so I am in favour of increasing company profits because of the necessity in the interests of every man, woman and child in this country to maintain the productive capacity of the industry of this country then I say that, in my opinion, there is a strong argument for increasing profits with the qualification that by that word "profits" I do not mean distributable profits.

1990. I do not mean that. Let us work on these assumptions. I ask you to assume, whatever may be the facts, that there is a difficulty in the case of a man engaged in manufacture, I do not want to cut across you on terms, who in a time of rising prices has to maintain a certain stock and a certain plant and equipment. You say he is taxed on what is really an excessive income, that his profits are over estimated in this case, and you want to do something. Let us assume that that is where we are. If it were shown, whatever the circumstances, that some industrialists were none the less quite capable of maintaining their plant and equipment and their stock without being relieved of tax would you say there was some difficulty in making a general rule, and if so would you agree that you ought to be able to deal with these cases in a more ad hoc fashion?—I would not agree. What would you have done with De Havilland's profits when they started?

1991. While you are here we might as well get the benefit of your views. In your memorandum you have not given us any help in finding a solution of the difficulty which, if I may say so, you set out quite clearly.—I can only apologise, Mr. Chairman, that my memorandum is incomplete in that regard. I will try, if it is your wish, to submit a supplementary memorandum of positive and constructive suggestions as to how tax might be altered or lessened in certain instances to meet Mr. Woodcock's point, but I am afraid that the memorandum is bound to come to the conclusion that it is the total weight of taxation which is at fault rather than the fact that some people should be taxed more or less on some kind of discriminatory basis based upon the knowledge which we have at this moment of the present position and future prospects of that particular trader.

1992. That is, if I may say so, an assertion that there is a case for discrimination in the taxation of income from business activities and personal activities.—At the moment am I not right in saying that the discrimination is against the business. The individual does not pay profits tax.

1993. Mr. Milford Tucker: He pays surtax on profits.—If he is lucky enough to have more than £2,000 a year.

1994. Mr. Woodcock: Would you say the relief you give to a man in business should be given to a man starting in business?—Yes, I think so without any doubt. I am a very strong believer in incentives to people to start in business. I do not believe in driving some of the inventive geniuses out of this country to another where taxation is more acceptable to them.

1995. Is that how it should affect industry, in effect, as a relief of capital expenditure?—That might be one form of it, Mr. Woodcock. I do not think there is any ground for saying that a man starting in business need not prove his case to the investor, and secure his capital at arm's length. I see no particular ground for saying that he should be spoon fed with his original capital. I do see some ground for saying that having acquired land, built a building, installed plant, employed labour and perhaps persuaded them to move into the neighbourhood he should then have every possible incentive to make his business into a future Morris Motors, or whatever it may be.

1996. I am not sure then that I have understood your case. I thought it was a case of keeping businesses in being, that a man is running a continuous business, and that he meets certain difficulties because he is taxed upon an assumed profit that is not, in fact, profit at all. That applies only to the man who is in business. It does not apply to the man starting business.—It applies to year 1.

1997. It does not apply to year 1 at the beginning of year 1.—Obviously you do not pay income tax or profits tax until you have an income. Nobody, of course, goes into business, or indeed continues in business, unless he can see it being continuously profitable.

1998. Surely the point was, here is a man who expends money in acquiring certain stock which he has to maintain and your point is that in times of inflation, that is of rising prices, his purchase, shall we say, subsequently for the same amount in volume is at the higher cost in money.—Yes.

1999. And that he has to provide for the additional cost out of income which has been taxed as profit.—Yes.

2000. Could that apply to a man starting in business?—Of course, because it happens at year 1 as much as it happens in year 101.

2001. Mr. Kerwick: I would like to ask a general question of Mr. Hume, and it has often been asked before, whether in his experience with companies when there is new capital needed today, owing to the absence of taxation is it raised by issue of ordinary shares or by notes and debentures as the general rule?—I have no statistics, Mr. Kerwick. I should say they would probably show that on account of taxation more money is being raised by way of loan capital at the moment expressed as a percentage of the whole than would otherwise be the case; but I think it relevant to mention that whereas interest is chargeable as an expense in arriving at profits tax liability the recipient of the interest does not receive it as franked investment income. To the extent, therefore, that institutions are now the main source of capital the liability for profits tax is transferred from the borrower to the lender. This does not manifest itself up to date very much, but I think it may be a feature in the future and one which is not to be disregarded. There is a slight tendency I notice to say to a prospective borrower, "I do not want a debenture, I would rather have a preference share." Profits tax is unquestionably diverting the whole flow of capital into industry and the greater evil, of course, is that it is impeding the flow of risk capital or venture capital as I called it before lunch. I hope I have answered satisfactorily.

2002. Yes, indeed. Do you think that the reason why you cannot issue ordinary capital is because of the increased liability for taxation, or do you think it is connected with something you said earlier on about the difficulty of raising risk capital today, that the institutions want safe investments and possibly are not inclined to go into risk capital? Perhaps it is that the institutions demand note and fixed interest investments rather than risk capital. I wondered what your view on that was?—I think the first part of your question can be properly answered by one of your fellow members who has just approached the market on a dual basis. There is, I think, no shadow of doubt that the institutions, and I speak particularly of the banks and the insurance companies, make their investments to match their own liabilities which are in absolute terms and therefore do not allow their funds to be ventured much. Therefore, taking even the most adventurous insurance companies, for I do not think banks ever buy ordinary shares, they are bound to be limited as to the extent they can venture their funds by circumstances which have relatively little bearing on their particular feeling at the moment as to whether they are

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Mr. H. N. Hume, C.B.E., M.C.

[Continued]

a good purchase or not. The other big source of institutional investment is the investment trust companies, which owing to their being prohibited from raising capital in the last few years as the result of the directive the Capital Issues Committee has had from the Treasury, are themselves generally so constructed capital-wise that they have a certain fixed capital in debentures and preference shares against which they feel they must match holdings of a like type. So that if you take away the ordinary investor who has got some pluck and who likes a bit of a gamble, you have taken an enormous force out of the market when it comes to venture capital. One has only to make an issue for a popular concern, which people get the idea is going to stand at a small premium, to realise what can come out once an investment looks attractive for a tax-free capital profit.

2003. Mr. Millard Tucker: Before we part, may I just ask you about one other matter, and it is nothing to do with this. You realise that we are a body charged with examining the system of taxing income and profits. In our present system we have a capital levy, of course, but it is not imposed until you are dead. Then the capital levy is imposed. Now there are, of course, profits which we describe loosely I suppose as capital profits. Some countries tax those capital profits. What is your view about adding to the ordinary income tax on ordinary income a tax on capital profits?—If it is a question of adding, Mr. Chairman, and you used the word "adding", I am dead against it, for it would remove the last spark of incentive that there is. I think it would give a disappointingly low yield. I think it would produce all kinds of barbedisks and inequities, and you have the illustration Mr. Bower gave you, an excellent one, about the man and his house. If you apply it to transactions on the Stock Exchange only you run the risk of producing distorted markets, tax sailing and all kinds of things of which there is evidence in America. I say that the trouble and difficulty of imposing and administering such a tax would in my opinion produce no result comparable with the efforts so made. The tax is laid on the ground that it would remove practically all of the last spark of incentive for maintaining the prosperity of this country.

2004. You say it would remove the last spark of incentive, incentive to what?—Get on and make a profit and employ people happily and well, export your goods, develop the Colonial Empire, do all those things which have enabled us to sit round this room today in comfort, wear a white collar and have a decent lunch, that is what I am saying, Sir.

2005. You think the activity of setting out to make capital profits when it is not a business, of course, is a desirable thing?—You are speaking about a gambler on the Stock Exchange?

2006. Yes.—I would be very glad to have tax assessed on my profits and losses in the 30 years that I have had anything to do with the Stock Exchange. I would get a substantial refund.

2007. What about those who spend their time, and a good deal of their time, every week in going in for football pools?—I do not know, I cannot give you an answer to that.

2008. Mr. Bullock: They are only the little brethren. —Some of them get big in the process.

2009. Mr. Millard Tucker: In a sense I suppose an activity to make money is just as much a taxable item as any other kind of activity which you undertake in order to make money.—The great bulk of activities to make money are, in fact, taxed. Trading is an activity to make money.

2010. Yes.—Working is an activity to make money.

2011. Yes.—The number of people who make fortuitous capital gains that might be considered to be anti-social is, I submit with very great respect, amazingly smaller than the theorists believe. I read in the paper this morning, as a result of the recent election, that somebody or other has lost £1,500 million, this is supposed to be some group of investors. It is wholly and absolutely inaccurate. If £1,500 million invested in Government securities falls a point nobody has lost in the taxable sense £15 million.

2012. Not unless you are forced to sell.—Quite, and if there is one-tenth of 1 per cent. more sellers than buyers what happens? The value is nothing or infinity if it happens that there are more buyers than sellers.

2013. Mr. Millard Tucker: Does any other member of the Commission want to ask a question on this topic? Perhaps we could confine it to this particular topic.

2014. Mr. Keldor: Mr. Hume said very few people made anti-social capital gains, but I do not think the Chairman meant to suggest that capital gains are anti-social. Capital gains are one of the consequences of successful operations, are they not?—Not successful employment. If you rise up from office boy to managing director there is no capital gain in that.

2015. No, but if you risk your capital in a venture, and that venture turns out to be successful, the important part of the reward is capital gain, is it not?—And that, of course, is what causes it to be described as a venture.

2016. There is nothing anti-social about it.—I said there is not, I agree with you. The gain I describe as anti-social is that of the man who sits in his club and plays the market, but there are very few of them, and they do not make much money when they try. Two per cent. stamp duty, perhaps I should have mentioned, knocks them on the head very hard.

2017. Mr. Millard Tucker: There is a good deal of activity on horse racing, gambling on the racing of horses, is there not?—I am ashamed to say I cannot discuss on that. All kinds of entertainment tax and so forth are levied, are they not? I do not know. That falls on winner and loser alike. The bookmaker presumably pays taxation on his gains.

Mr. Millard Tucker: Yes. Now, Mr. Hume, it only remains for me to thank both you and Mr. Warnock for all the trouble you have taken, and for all the assistance you have given us this afternoon, we would like you to know we appreciate it very much indeed.—Thank you very much, Mr. Chairman.

The witness withdrew.

MINUTES OF EVIDENCE

TAKEN BEFORE THE

8

ROYAL COMMISSION ON
THE TAXATION OF
PROFITS AND INCOME

EIGHTH DAY

Friday, 30th May, 1952

WITNESSES

Mrs. URSULA K. HICKS	- - - - -	Questions 2018-2215
Mr. F. H. HUGHES	- - - - -	Questions 2216-2283
Mr. H. S. BOOKER	- - - - -	Questions 2284-2359



LONDON: HER MAJESTY'S STATIONERY OFFICE

1952

FOUR SHILLINGS NET

TERMS OF REFERENCE

(As amended 11th March, 1952)

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages: to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer: to consider the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden fairly among the individual members of the community: to make recommendations bearing in mind that in the present financial situation it may be necessary to maintain the revenue from profits and income: and, in so far as they make recommendations which would on balance entail a substantial loss of revenue, to indicate an order of priority in which such recommendations should be taken into consideration."

NOTE

For the guidance of intending witnesses the Commission published a list of the main heads under which evidence was invited. They explained that the list was not necessarily exhaustive and that witnesses could put in evidence on questions not specifically mentioned, provided that they fell within the Commission's terms of reference. The list is reproduced below.

A. General social and economic questions

1. Is the present system of taxation satisfactory, or could it be improved, in relation to:—

- (a) Incentives,
- (b) risk bearing,
- (c) encouraging savings,
- (d) the control of inflationary or deflationary tendencies,
- (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment,
- (f) its effect on the distribution of personal incomes,
- (g) other economic and social objectives?

These questions can be considered in relation to the taxation of:—

- (i) salaries and wages (P.A.Y.E.),
- (ii) profits of businesses and self-employments,
- (iii) dividends and other sources of income.

2. Would it be advantageous to link Income Tax with social security payments and contributions?
3. Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

B. Particular matters

4. Is the taxation net drawn too widely or too narrowly in relation to:—

- (a) the taxation of United Kingdom residents (companies or individuals) on overseas profits,
- (b) the taxation of non-residents on United Kingdom profits,
- (c) the definition of residence, etc.?

5. (a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particular—

- (b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?

6. Is the basis of computing income from property under Schedules A and B satisfactory?

7. Should the present rules about deductions for outgoings and expenses be altered?

8. Are the provisions for relief in respect of double taxation satisfactory?

9. Should the present system of graduation by means of the exemption limit, personal allowances, reduced rate relief and Surtax be altered?

10. Should the existing differentiation between earned and unearned income be extended or reduced?

11. Are alterations necessary in the rules governing personal and other allowances?

12. Should the rules about the taxation of husband and wife be altered (a) as regards aggregation; (b) in any other respect?

13. Should P.A.Y.E. be altered or abolished?

14. Should the principle of deduction at source be extended or restricted?

15. Should the method of assessment to Surtax be altered, and in particular should it be deducted from salaries?

16. Are any alterations desirable in the system of administration and the functions of the various statutory bodies or persons connected with taxation?

17. Are any changes in the provisions against avoidance and evasion desirable?

18. Is any alteration necessary in the rules governing the taxation treatment of special classes of taxpayers (e.g., public corporations, co-operative societies, charities)?

THE ROYAL COMMISSION ON THE TAXATION OF PROFITS AND INCOME

EIGHTH DAY

Friday, 30th May, 1952

PRESENT:

THE RT. HON. LORD RADCLIFFE, G.B.E. (Chairman)

MRS. VERA ANSTEE, D.Sc.

MR. W. F. CHECK*

SIR HARRY GILL, J.P.

SIR GEOFFREY HEYWORTH

MR. W. J. KIRWICK

MR. J. MILLARD TUCKER, Q.C.

MR. G. WOODCOCK

MR. E. R. BROOKES (Secretary)

MR. D. G. DAYMOND (Assistant Secretary)

* Present only for the evidence of Mr. H. S. BAKER.

MRS. URSULA K. HICKS; called and examined.

MEMORANDUM SUBMITTED BY MRS. URSULA K. HICKS

1. In this Memorandum I shall confine myself entirely to problems connected with the personal side of income tax. These problems have become acute owing to the very high rates of tax which it has been found necessary to continue into the post-war world, and so long as these rates have to be retained the problems are not wholly soluble. There are, however, matters calling urgently for reform which are only partly related to rates of tax, being due primarily to such factors as the grafting of the P.A.Y.E. system of collection on to the traditional method of tax collection without a proper integration with that system, and the continuous growth of the number of income and surtax payers with the course of inflation, in addition to the fact that nominal exemption limits are still lower than they were before the war.

2. I shall deal first with problems connected with income tax as it is now levied, including (i) the possibility of simplifying the withholding system so as at the same time to reduce the disincentive effects of P.A.Y.E. and the costs of administering it, and (ii) the possibility of restoring the unity and certainty of income tax as a levy on total income, especially in respect of mixed incomes. Secondly, I shall discuss the merits of an annual tax assessed on capital (or property), but expected to be paid out of income; and thirdly the desirability of including the taxation and relief of capital gains and losses within the income/surtax structure.

3. I have had the benefit of seeing a number of the relevant documents which have been submitted to the Royal Commission. I have also examined as well as I can at a distance the parallel systems used in the U.S.A. and Sweden, as the two countries most likely to provide ideas which might be useful in this country. It is noticeable in particular that the system of withholding as now used in the U.S.A. seems to give universal satisfaction, does not call for large refunds to taxpayers and is held not to be disincentive.

1. Weekly Wage Incomes

4. From the economic point of view the present P.A.Y.E. system has two disadvantages, which together undoubtedly have a considerable disincentive effect. In the first place where the difference in marginal and average (incremental and effective) rates of tax is large the additional tax to be paid on extra effort may be very high indeed. In the second place the current reduction—or repayment—of tax when income falls, due to the crediting of allowances under the cumulative system, is a temptation to voluntary absenteeism. These are the two evils which it must be the object of any reform to remove.

5. On the other hand the great advantages of P.A.Y.E. over any previous method of withholding wage income are first, that current income is taxed currently so that when earnings fall off (as they are likely to do over the

taxpayer's lifetime even if wage rates and hours remain steady) all danger of having to pay tax proper to a higher income than that at present earned is removed. Secondly, the current taxation of current earnings constitutes a better method of economic control than the taxation of past earnings, since changes in revenue are always in step with changes in the national income. It would be a definite loss to sacrifice any of this currentness (for instance in an effort to break the close connection between marginal effort and marginal tax). Indeed, as I shall argue later, there are strong arguments for extending the system of collection of current earnings to all incomes.

6. The disincentive danger inherent in a big gap between marginal and average rates can be reduced by making the steps in the progression small (as they are in the surtax range); but this would be administratively complicated if extended right down the income scale. The only complete cure for the "gap" trouble is a proportional tax (so that marginal and average rates always coincide). The obvious solution therefore seems to be a simple proportional tax covering most of the weekly paid taxpayers, or broadly the numbers additional to those who were charged to income tax before the war. When this idea was first put forward, shortly after the end of the war, it would have been difficult to introduce without serious loss of revenue from the higher wage incomes; but the extension of the higher reduced rate band in 1948 has already sacrificed revenue at that point, so that no further serious loss need be encountered now.

7. The critical point is, however, the position of the allowances, both as their aspect as part of the social welfare programme and as an integral part (indeed in the lower ranges of income the main part) of the mechanism of progression in the income tax system. The allowances at present complicate P.A.Y.E. in three ways: (i) by making necessary a great number of codes to cover their various possible variations, (ii) through the necessity to credit them currently under the cumulative system, thus necessitating a separate tax table for each week of the tax year, and (iii) as being the main cause of reductions or repayments of tax when earnings fall.

8. The only alternative which would break the disincentive effect while retaining more or less the present British system of allowances would be to abandon the cumulative principle from week to week. I understand some sections of industry already use a four-weekly balancing period; but although this should be an improvement it would still leave room for considerable disincentive. It would still leave room for considerable disincentive if it were possible to contemplate the abandonment of the cumulative system completely, and make only an annual settlement, then the whole system of separate tables for each week could be abandoned; but there might be a danger of the taxpayer getting seriously out of equilibrium with the revenue before the end of the year.

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9. The Americans have got round this particular complex of problems in a way which is perhaps a little rough and ready on British standards, but which seems to give satisfaction. It refers to the income groups up to \$5,000, and since the progressive marginal scale is already applied in that range the greater simplification of a proportional tax is not available. The allowances are given as flat sum exemptions (as the personal allowances are given in this country), but are simplified to the point at which they become a series of "unit" exemptions, or raising of the effective exemption limit to tax. The worker declares in advance how many of these exemption units he is entitled to, on his family circumstances, and the employer deducts the correct multiple (one to ten) from his pay, according to very simple tables; there are thus effectively only ten "codes".

10. Within this income range a flat 10 per cent. is allowed for tools and other allowable expenses. Each worker has a card recording his exemptions, which he presents to his new employer when he changes his job. He has a strong sanction to do this, as until he receives the card the employer is bound to deduct tax without any exemption. As I understand it, tax is deducted non-cumulative week by week on the basis of expected annual liability, by means of simple tables supplied by the revenue authorities to employers, the worker supplying particulars of the exemptions (allowances) due to him, as certified by the Bureau of Internal Revenue. The return is made by the worker on an extremely simplified form, which is only available to the lower income groups.

11. By the device of the use of expected income as the basis for withholding a good deal of the advantage of the cumulative system can be retained, and it does not appear that the taxpayer gets seriously out of equilibrium with the revenue. He is finally brought into equilibrium at the end of the year, any overdeduction being made good in the form of a bonus bearing 6 per cent. interest. Any under-withholding must be paid within 30 days. It is obvious that the close tie up between marginal income and marginal effect is completely avoided under this system.

12. If, however, a proportional tax were introduced for the lower income range in this country (up to somewhere between £450 and £600) and the allowances were also brought within the proportional system, enormously greater simplification than the American would be possible, without sacrificing so much of the cumulative principle. If all the allowances were given in the form of percentage deductions from tax liability (as the earned income allowance is in fact given), the percentages could be as simply aggregated as the American unit exemptions, and would provide a far more flexible system. No formal exemption limit would be necessary as the allowances would provide an effective one, differing as it does today according to family circumstances. It would be an obvious simplification to include also the present social insurance contributions within the system; substituting for the present flat sum payments a flat percentage. Under this system it would still be necessary to obtain, and pass on to the employer, particulars of the employee's family circumstances, and rudimentary "codes" would still be required; but there would be no weekly tables.

13. To this great simplification there appear to be two minor objections: (i) the element of progression now obtained at the lower end of the tax structure by the operation of flat sum allowances would be lost, and (ii) the miscellaneous other flat sum allowances for tools, small property income not tax deducted, mortgage interest and so on—now included in the coding, would have to be separately ticked. No doubt some simple, if slightly rough and ready, method of fitting them into the percentage system could be found.

14. The first point is more important; it should, however, be borne in mind that although the present system of progression in the lower income ranges would be sacrificed, on the other hand the present regressive element of the flat sum social insurance contributions would be abolished. There would also be a much more adequate "lateral progression" within each income group according to family circumstances. A minor advantage of putting both tax and personal allowances on a proportional basis would be that changes in rates would impinge directly on marginal effect (as does the proportional earned income relief), instead of only on average liability to tax, as the present personal allowances do.

II. Higher Incomes

15. Wherever the upper limit of the proportional tax were set it would still leave some weekly wage earners to be charged under the normal income tax, and the difficulty of the gap between marginal and average rates of tax would still remain in that range. Disincentive would perhaps be less serious than at a lower range because of decreased importance of overtime. It would be minimised if progression proceeded in a series of small jumps instead of in one large one.

16. The real problem of integrating a system of current withholding such as P.A.Y.E. with traditional methods of tax collection arises, however, in connection with mixed incomes, either those which are wholly earned but only part of the earnings comes within the withholding system, or those which are derived partly from work and partly from property.

17. The basic difficulty for the taxpayer in these circumstances (and it is a very serious one) is that tax is being collected simultaneously on the accounts of more than one year—at least two years for income tax payers, and at least three years for surtax payers. With the system now used by the Inland Revenue for "spreading" under-withholding over a number of years the taxpayer may in fact be being charged on the accounts of four or five years, and he has no means of knowing when he has finished with any particular year. The allowances may be set off against tax on property or other income, against P.A.Y.E. income or partly against one and partly against the other. It is worth noting that if they are set off against P.A.Y.E. income, and income from other sources has tax deducted at the standard rate at source, it is actually possible for the Inland Revenue to assess a taxpayer at the appropriate progressive rate on the whole of his income, without ever ascertaining the total, so long as it is safely below the surtax limit.

18. The converse of this system, from the taxpayer's point of view, is that he never receives notice of his total liability set against his total income; and it is only on the receipt of such an account that he can check whether the liability has been correctly assessed, and how far he has discharged it at any moment. The receipt of demands for the payment of considerable sums (including "underpayments" on past years), presented without warning and at irregular intervals, is a real hardship for the middle income ranges who cannot afford to keep large balances idle in the bank to meet liabilities which they cannot foresee, either as to date or as to amount. I feel very strongly that this additional burden on already highly taxed incomes should not be allowed to go on, and I believe it could be abolished with negligible loss of revenue. I believe we are alone among civilised nations in tolerating this uncertainty.

19. In other countries (for instance Canada, U.S.A. and Sweden), the confusion due to being charged to tax on several years at once is avoided because at the time of the change over to their respective withholding systems the whole of the tax was changed to a current base. This country was afraid to take the full plunge because of an eventual loss of revenue, although the difficulty was swallowed in the case of weekly wage earners. I would strongly urge the advantages of changing over now to complete current assessment on all incomes. The supposed loss is really a delusion. So far from there being a loss, under present circumstances with rising incomes and tax rates, the revenue would actually gain by advancing liability, while the fact that taxpayers had now to pay on present higher instead of last year's lower incomes would facilitate the control of inflation.

20. The method of taxation of current income (outside the withholding system) used in the U.S.A. is very simple and appears to work smoothly. On or before 15th March (the third month in the tax year) all taxpayers furnish two returns: (a) an account of income from all sources received during the year recently closed (this corresponds to the British income tax return), and (b) an estimate of income tax which will be due during the year just started. The whole of the estimated tax due (outside the withholding system) may accompany the estimate, or alternatively a quarter of the liability, the remainder being discharged in equal instalments quarterly. Any balance due to the revenue from the previous year must be paid on 15th March. For incomes under \$5,000 the revenue takes the initiative in informing the taxpayer what his

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MRS. URSULA K. HICKS

[Continued]

tax bill (or alternatively refund) is. Any tax due must be paid within 30 days, subject to penalties and a 6 per cent. interest charge on overdue accounts.

21. A change over to the taxation of all kinds of income on a current basis would be an immense simplification and clarification for the British taxpayer. It brings with it the further question whether it would not be possible at the same time to rely wholly on progressive rates of tax (in the manner of surtax) for the progressive mechanism, instead of partly on the remains of the flat rate allowance system which otherwise presumably would continue to be used in this range. If this were done it would in a sense imply bringing down the surtax exemption limit to the point where the proportional tax ended.

22. This change would have two advantages. In the first place it would be possible to grade the progressive rates more finely than at present, and so in this important range (c. £500 to £2,000) keep marginal and average rates closer together. In the second place the taxpayers in this range would necessarily work on an account of total tax set against total income, and thus the remaining uncertainty in the present method of collection would be removed. The system would presumably be slightly more complicated than the present one, but the number of taxpayers with mixed incomes in this range is not after all so very large. Under such a system there would not formally be any "standard rate" in the old sense; but it should be simple to select an appropriate rate for the deduction at source of property incomes under Schedules A and D. It would be an additional advantage that the lag in surtax collection would largely be removed, since the taxpayer would return and pay his whole tax liability in the one year. This would improve the economic "fit" of income tax collections to the national income, even if in practice full surtax could not always be finally determined in the current year.

III. Annual Taxes on Capital

23. A percentage discrimination against incomes from property (in the form of earned income relief) has been the traditional way of taxing "capitalist's advantages" in this country. When it was first introduced the discrimination against property incomes was justified mainly on the ground of the greater continuity of such incomes relative to incomes from work. It would, however, be more logical to tax capitalist's advantages directly, by taxing the capital, since much of the advantage accrues (both in respect of its aspect as a re-insurance against sudden need and its aspect of a basis for taking advantage of sudden opportunities) still remains even if no income is received from the capital.

24. Personal capital is now subject to heavy and progressive death duties in this country; but there is another line of argument which leads to another type of capital tax—one assessed annually, and for the most part expected to be paid out of income. This type of tax has two possible advantages over high rates of surtax. In the first place it should be less disincentive to effort, since liability to the tax is unrelated to current effort. (On the other hand the current removal of a portion of capitalist's advantage might well have a more deleterious effect on the propensity to save than either high surtax or a capital tax assessed only at death.) In the second place a capital tax can be assessed at rates that exceed 100 per cent. of current incomes and can thus be made to have a greater effective progression if that is desired. Naturally the more an annual capital tax becomes a real tax on capital the more will death duty revenue be correspondingly reduced. In the countries which make use of an annual capital tax inheritance taxes are not at all so fully developed as they are here, so no great problem arises in this respect.

25. Thus there are good theoretical arguments in favour of a capital tax; its drawbacks are practical rather than theoretical, and are mainly related to the very serious difficulty of successfully valuing assets. For the capital tax to have the same degree of equity as an income tax, both in respect of timing and of the correct assessment of relative liabilities, the values put upon property should be genuine current market values. Neither conventional values on the one hand, nor capital values derived by capitalising income should be accepted as adequate. (This

was clearly demonstrated in the Inland Revenue Memorandum on a Capital Levy after the 1944-18 war.* Further, the capital values selected should strictly relate to the relevant tax period, neither to an arbitrary point within it nor to a past period.

26. These points need only to be mentioned to show how extremely difficult is the process of adequate valuation for a capital tax other than death duties. (Even there a sudden change in stock market values can make the valuation considerably arbitrary.) The experience of countries which at present operate capital taxes of this nature, for instance the U.S.A., Sweden and Denmark, is not very encouraging. In the case of the U.S. the (property) tax is used only at the state/local level, which fact may be held responsible for some of the shortcomings of the valuation process; but in the Scandinavian countries the full powers of the central administration are brought to bear on it.

27. In both Sweden and the U.S.A. the capital tax is really a survival from an archaic tax structure, dating from the time before an effective income tax was available. In Sweden this is fully realised, but it is unlikely to be abandoned, partly on the principle that an old tax is no tax, and partly because it does bring in a good deal of revenue. In a number of states in America the property tax has now dwindled into little more than a tax on land and buildings, differing little in its long run effective incidence from the British local rate, although assessed on owners and on capital, not on annual values. Some states, however (for instance Illinois), do try to work the property tax as a comprehensive tax on capital, with results that are widely acknowledged to be deplorable from the point of view of equity.

28. In Sweden great difficulties are acknowledged to be encountered in the valuation of all but liquid assets. For companies special periodic assessments are made, but these are naturally only correct for the time of assessment (and in so far as assessment was not simultaneous might be very iniquitable). Farms and forests are given conventional values that are acknowledged to be highly favourable. Apart from these special cases there is said to be some evidence of more or less deliberate discrimination in favour of particular types of property. Personal effects, including old masters and objets d'art are exempted from the tax.

29. Although nobody in Sweden seems to be proud of the tax, and it does not appear to be considered that it could be useful as an instrument of policy, some experts support it because they consider that it is a more effective way of making small traders contribute to the revenue than an income tax. This may be because the revenue authorities have more opportunities of going into the affairs of firms at the periodic valuations than they would have of checking income tax returns. Where the fortunes of a firm change seriously between valuations the tax must, of course, be correspondingly inequitable.

30. The most relevant experience of the capital tax is probably that of Denmark, which introduced a capital tax in 1909, shortly after the establishment of income tax, and made it progressive from 1912. On the wealthy the nominal rate of tax (24 per cent.) may now exceed 100 per cent. of income; but at the same time the maximum rate of death duties is only 35 per cent. Moreover, an elaborate system of offsetting payments against next year's income tax liability implies that in practice Danish direct taxation is both considerably less high and less progressive than British.

31. Roughly half of the property in Denmark is agricultural; and one of the justifications for the capital tax is the notorious difficulty of assessing farmers to income tax. Valuations of agricultural property are carried out quinquennially for the land value tax and these are used for the capital tax also. It should be noted, however, that these land values are not based on market values, but on a conventional value based on an assumed medium fertility and average condition of cultivation. After the war Denmark had a special assessment of all classes of property in connection with a post-war capital levy. This naturally provided much better data than would normally

* Appendix XXII to the Report of the Committee on National Debt and Taxation.

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be available, but it is now considerably out of date, although liability has not yet been finally determined under it.

32. In general the valuation of capital is acknowledged in Denmark to be more difficult than the valuation of income.Bearer bonds are widely used to evade tax; the inventories of small firms can never be satisfactorily ascertained. It is held by some authorities that over time venture capital is discriminated against because on the average the rate of return is lower than for established enterprises. The Danish revenue authorities estimate that they collect 85 per cent. of the tax due on incomes, but only 70 per cent. of that due on capital, so that it would appear that collection, as well as assessment, is more difficult for a capital than for an income tax.

33. In view of the experience of countries with efficient revenue administrations it would seem that nothing would be gained by the introduction of an annual capital tax in this country: anything that might be gained directly in incentive (if it were a substitute for high surtax rates) would certainly be lost in equity. It seems that an earned income relief in income tax is still the most practical way of allowing for capitalist's advantage; while at present rates (which after all have not been very long in operation) death duties are an effective way of progressively equalising the distribution of capital.

IV. The Treatment of Capital Gains

34. Capital Gains are not a component of the normal income stream, except in the case of professional market operators; but they do add to the individual's command over goods and services in exactly the same way as income does. This is obvious in the case of a realised capital gain; but a similar advantage accrues even if the gain is not realised through the greater power of borrowing which it bestows.

35. The taxation of capital gains is usually advocated for two reasons. Large and sudden increases in command over resources are thought to be bad, and somehow unfair, leading to an increase in economic (or even political) power. This argument was very important in the U.S.A. in the days before there was an effective federal income tax. Secondly, capital gains may be engineered as a substitute for income, if either they are not subject to tax or are taxed at lower rates than income. This is a real evil which every income tax authority has to fight to some degree; the question is to what extent it can be eliminated by any practicable tax on capital gains.

36. In the absence of general inflationary conditions significant capital gains are unlikely to be widely realised; they may, however, occur for a number of reasons. In the first place they will accrue to shareholders in successful companies, especially those who got in early in the development of a new product. Such capital appreciation is an essential part of the reward for venture capital and its special taxation would be quite unjustified; high rates of surtax are already too deterrent to venture capital. Secondly, spectacular capital gains may sometimes be realised by successful amateur but fairly regular market operators; the late Lord Keynes is a striking example. The majority of such speculators are probably not heavy net gainers in the long run, and little revenue would be collected by taxing their capital gains as such, if, as would only be fair and logical, full relief was allowed for losses. Possibly a more detailed return of assets, and changes in them during the year, made at the same time as the income tax return, would be of assistance in determining in marginal cases whether the operations were sufficiently frequent to be considered a part of the normal income stream, and consequently taxable to surtax, or whether they were merely casual and could be neglected. Such a return might also be useful for other purposes.

37. Thirdly, in certain circumstances capital gains may be acquired through the deliberate under-distribution of profits and subsequent substitution of capital bonuses. This is probably the most common type of the deliberate substitution of capital for income receipts in order to evade surtax; however, it almost implies personally controlled companies. The revenue authorities in this and other countries (notably India) have developed a number of devices for estimating the capital required in a particular type of business, and taxing any excess held idle at the rates it would have borne if distributed.

38. Capital gains which are at all conspicuous and general are likely to have some particular cause—too easy conditions in short-term markets or not generally inflationary conditions. They may also come about from a general fall in interest rates, implying a general rise in capital values, which will give additional opportunities for speculation. In the past spectacular capital gains have often been made in localised booms in particular markets, such as real estate or a particular commodity. In very many cases the exciting cause has been exceptionally easy credit. In all such cases the primary remedy is on the side of monetary control. Spectacular booms on the stock exchange or in commodity or real estate markets are now very unlikely to occur in this country owing to recent changes in marketing mechanisms, as well as to the drastic rise in stamp duties on sales.

39. Capital gains made under general inflationary conditions do not really seem to be an eligible subject for special taxation; it would again be much more appropriate to tackle directly the conditions which made them possible. In many cases the "gains" are only paper gains, and unless prices in the field where they have been made have risen more than other prices (including wages) the nominal gains are real losses. Further, when the inflationary conditions pass away these would in equity have to be compensation for losses.

40. The case for taxing capital gains is not improved when we turn to look at the types of capital gains taxes which other countries have found it practical to impose. The correct taxation of capital gains would require the imposition of tax in the period in which the gain was made (whether realised by the sale of the assets or not) and would similarly call for current relief of losses. This would imply a beginning and end of year valuation of assets, either by the taxpayer or by the revenue authorities, and would thus bring in all the difficulties of valuing capital, by the back door.

41. In practice I believe no existing capital gains taxes attempt anything beyond the taxation of realised gains; and none allows anything like symmetrical relief for losses. This leads to inequity and hardship in several ways. In the first place forced sales or liquidations, and unwanted bonuses (where a steady income would have been preferred by many shareholders), are heavily penalised by qualifying for high progressive rates of tax. Secondly, gains are likely to be made in one period but realised in a different one; this any control element in the tax will not be available when it is required. Thirdly "incomes" which include capital gains become much more fluctuating than pure incomes, so that over a period the progressive taxation of income is higher than it would have been otherwise. I believe that it is the obvious hardship of the creation of highly fluctuating incomes which has tended to make taxes on capital gains soft relatively to income taxes.

42. In order to reduce these causes of inequity some existing capital gains taxes assess at full progressive surtax rates only those assets which have been held for a short period. Others allow "compassionate" exemption for forced sales, usually only available by negotiation with the revenue authorities. The U.S.A. capital gains tax is typical of the shortcomings of the tax in practice, and is so recognised by tax reformers. Gains are taxed only when they are realised. If the asset has been held for less than six months it is taxed exactly on all forms with other income, at the appropriate surtax rates (the maximum rate at present being 75 per cent.). If the asset has been held over two years it comes under the capital gains tax, the rates of which cannot exceed 25 per cent. If it has been held somewhere between these two limits the taxpayer can choose under which tax he will pay. The incentive for higher surtax payers to qualify for the capital gains tax is obvious. In the American tax the relief of capital losses is very limited and quite unsymmetrical with the taxation of gains.

43. A much more ingenious capital gains tax has been proposed for Japan by a group of American experts. It is proposed that capital gains and losses should be treated symmetrically within a general system of taxing fluctuating incomes. Actual payment would take place in the year in which the gain was made, but equal fractions of this payment would be credited against liability to income tax over an appropriate balancing period (such as ten years), so that over the period income, including capital gains, would be taxed as if it had accrued regularly.

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44. If this proposal proves to be administratively feasible it will obviously be a considerable improvement in equity, and would moreover provide a general method of taxing fluctuating incomes fairly. Different balancing periods would be appropriate for different types of fluctuating income (longer than ten years for authors, shorter for fishermen). It would seem to require a rather complicated system of suspense accounting, but with modern mechanised methods this is perhaps not too serious. The chief weakness of the plan seems to be that it requires the annual self-valuation (not merely letting off assets by the taxpayer). Checking these returns again brings back the problem of capital valuation, by the back door. If the tax is operating in a period of inflation there is the further difficulty that gains will differ enormously according to the date from which they are reckoned. (The impossibility of simultaneous valuation also imports great unfairness into other capital valuations during inflationary periods.) In Japan the process of capital revaluation, designed to establish a firm and more or less equitable base from which future gains and losses would

be reckoned, was caught halfway through by the Korean war, which caused a further 40 per cent. rise in values.

45. High rates of surtax unquestionably stimulate the substitution of capital receipts for income (since in one way or another the taxation of capital gains tends to be softer than the taxation of the normal income stream). They similarly stimulate other forms of evasion, such as expense accounts, and undeclared transactions; moreover such forms of evasion are the more difficult to check because the propensity to evade is by no means confined to income receivers. Such increased stimulus to evasion must be counted among the increasing costs of high taxation. In view, however, of the inequity of taxing many of the capital gains which are merely nominal and not intended to evade surtax, as well as of the unsatisfactory nature of the capital gains taxes which alone seem to be practicable, it would seem more desirable to continue to tackle the capital gains problem within the framework of the ordinary income tax as is done at present.

22.10.1951.

EXAMINATION OF WITNESS

2018. *Chairman:* Mrs. Hicks, the Commission are very grateful to you for the memorandum and the ideas that you have put in. There are one or two questions which we have, and we would like to be quite clear what the suggestions are that you are making. We have all read your memorandum through, of course, and have it in mind. It deals with two or three separate subjects, and we shall take our questions separately with regard to them. Have you anything that you would like to supplement your memorandum with before we come to our questions, because possibly it would shorten the questions?

—*Mrs. Hicks:* There are, of course, a number of points that I did not touch on in the memorandum, and I could, if you wish, expand on any of those points. On the points that I have made I would perhaps like to emphasise very strongly one or two. First of all the desirability of some sort of simple tax which would cover the majority of weekly wage earners. Secondly, the desirability of exploring all possible administrative methods of making the whole of the income tax, including surtax, as current as possible, so as to get away from the system in which the taxpayer in the middle and higher ranges may be paying tax on a number of years at once, and in which it is very difficult for him to find what his true liability for any year really is, so that he has difficulty in knowing what to reserve in order to discharge it. Part of that, of course, arises out of the method of P.A.Y.E. because part of the difficulty is due to under withholding (so to speak) of allowances; under withholding due to the operation of the allowances system, and that might come out in the way a bit if the system of P.A.Y.E. were amended, but I still think that there are very strong arguments for making income tax as current as possible, largely arguments on economic grounds as well as avoidance of personal hardship. You will probably later go into the details of a possible simple tax system so I need not mention that.

2019. I dare say that will emerge from our questions?—*Quite.*

2020. There are one or two things that I wanted to ask, just to follow the thread of your argument. You first of all, I think, concentrate your attention on the problem of taxing weekly wage incomes, looking at P.A.Y.E. as it is today. You say that it has, in your view, two main advantages, one is that it fixes current taxation on current earnings; you attach importance to that?—*Yes.*

2021. And secondly that by so doing it gives the authorities a more sensitive economic control than if you adopt a past standard?—*Yes.*

2022. Would you elaborate that second point? What have you in mind particularly with regard to it?—I have in mind that you keep your tax revenue closely in line with fluctuations in the national income. When the national income is rising then you take the full tax liability on the higher incomes away from people. When the national income is falling then you take the smaller tax

liability instead of the higher tax liability from previous years as you would if you are taxing in arrears. It is just that current payment gives you a better control.

2023. Would it be true on the other hand that if you base yourself on a previous year's performance you can more accurately estimate what the yield from your tax in the current year will be?—Of course, that is true, but I still think that you can make a first approximation which is not so very inaccurate, and then even up at the end of the year as it is done, for instance, I think very successfully, in the United States.

2024. Now what you find against the present P.A.Y.E. system in the main is, you draw attention to this point, that for those people whose extra effort means extra reward it throws a spotlight on the burden of the marginal rate?—*Yes, particularly where there is a large divergence between the marginal and the effective rates.*

2025. And P.A.Y.E. has also this consequence, that if, in the course of the year, you are not drawing a wage owing to being absent or sick or unemployed, then you have in many cases a right to get the tax back?—*Yes, it depends on the operation of the cumulative system, but I would still strongly support the basing of liability on the expected year's income rather than week by week according to a weekly wage tax, which does come very hard on wage earners with fluctuating incomes. I still think you could get that by means very largely of a proportional simple tax.*

2026. Why do you think it is a bad element in P.A.Y.E. that in these periods of absence or unemployment or sickness you should have the right to have your tax repaid and something back?—I think it is disincentive. I think it is extremely fair, but I think it is disincentive.

2027. Have you practical experience of its disincentive effect, or is it what strikes you from looking at the thing as a theorist?—*Yes, mainly the latter, but one has had conversations with people who say they have worked enough now and, "We can very well take the time off now" and so on.*

2028. Then I think you draw attention to the advantages of the American tax system with regard to wages?—*Yes, merely that that is a simple tax system really effective which is yet imposed on the annual income and not just a weekly wage tax. The further advantage I see in it is the great simplification of the allowances, the personal allowances. I think that a better system than the American scheme of allowances could be devised but I think that their experience points along the right direction.*

2029. Their system is to give allowances by way of flat rate units of 600 dollars each, is that not so?—*Yes.*

2030. Have you in mind that their system, according to my information, is only of provisional withholding followed by an assessment at the end of the year?—*Yes.*

2031. You have to face the administrative problem at the end of the year of assessing wage earners, have you not?—*Yes, it means that you have rather a peak business administratively, but during the course of the year the*

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thing is extremely simple, because it throws much less on the employers, although no doubt rather more on the Bureau of Internal Revenue, but, on the other hand, there is great simplification, at that particular period it throws more on the Internal Revenue.

2032. But its advantage in your eyes is that it is not cumulative during the year so far as the withholding goes?—Yes, its advantage is very largely that like a cumulative system it is assessed on the total year's income rather than week by week, so that you do not get heavy over taxation of people with fluctuating incomes.

2033. Can you make it plain to me, under their system (which contains very simple tables for the employer to use, if I understand it) what rate they are trying to extract from the wages that are paid by way of withholding?—Since the very simple system whereby the Bureau of Internal Revenue tells the taxpayer what his liability is more or less, goes up to 5,000 dollars; in fact the progressive scale has already started before that. The American system consists of what they call the normal income tax and surtax, the normal income tax being very low, so that practically everyone except the lowest wage earner comes in for surtax, and the amount they are trying to get out of a taxpayer of course corresponds to his place on the progressive scale. It would be much simpler in such a simple tax as some of us advocate here, because there would not be a progressive scale operating in the range of the simple tax, or at any rate only at the upper end where it overlaps with income tax.

2034. I am not sure I quite follow yet. In the American system if I understand it rightly, an income up to 2,000 dollars per annum pays a flat rate of 20 per cent.—Yes.

2035. Are the tax tables which are supplied for the employer all based on the assumption that they are dealing with an income not above 2,000 dollars?—I would not like to be absolutely certain of this, but I think they are based on whatever the chap's expected income is. If it is more than 2,000 dollars then they would withhold whatever is the proper rate on what the expected income is.

2036. Who makes the decision then on behalf of the authorities as to what a man's expected income for the year is to be taken to be?—That is what he makes in a return. He makes a total return of expected income for the year that has just started and received income for the year that has just ended.

2037. And according to his estimate which he sends into the tax authority the withholding of the current year's tax proceeds, does it?—Yes.

2038. So there is no burden on the employer, he merely takes what the employee says?—He merely takes what is given him, yes.

2039. You then say, having in mind the American system which does end in a final assessment of everybody after the end of the year, would it not be better in this country if we had a truly proportional tax for this type of income?—Yes.

2040. What I have not got clear is, to get a proportional tax you must fix some rate, must you not?—Yes, of course.

2041. What is going to determine in your scheme what the rate is to be?—That depends on the total revenue that you want to get. So far as the Commission is concerned it would want to recommend a rate presumably which would bring you much the same revenue as you are getting already for people within those income ranges.

2042. That means that if you change over, for the first year after the changeover you would look at the total sum raised from incomes up to a certain amount per annum, and you would require a proportional rate from everyone in receipt of income up to that limit based on extracting the same amount as you got last year, is that the idea?—On the average. Whatever simple tax scheme you adopted some people would be a bit up, and some would be a bit down, and, of course, consequently it would be ever so much easier if you could change over in a year when it was possible to have a slight alleviation of the total income tax burden so that everyone could have a prize.

2043. I see the psychological advantage of that, certainly. But the result would be that there would be no personal exemption in it, everyone would have this proportional rate taken off his weekly wage?—Yes, that is a matter to decide. I think for employed persons you

would have to have everyone taxed in the first instance, but I think it would be possible to have an exemption limit. That would come out in the allowances probably. You could have your allowances so that there was a personal allowance which gave you an effective exemption limit.

2044. I thought you were advocating, if it could be done, that allowances should all be expressed in percentage terms of your weekly remuneration?—Yes.

2045. Would you ever get an absolute exemption, as you get it now under our system, by other means?—You could, because even if all the allowances were to be percentages there would be nothing to stop you having an absolute amount in addition as an exemption limit if you felt that it was extremely onerous on the young worker, for instance.

2046. I suppose a person could be entitled to so many percentages added together as came to 100 per cent. in which case he would be free?—Yes, I suppose that might happen in principle, but I do not think that the percentages could be fixed so high in practice as to make it a very real case. I think that the exemption limit proper should be something separate from this.

2047. In that case you would have everybody paying on those reduced percentage claims?—Yes, in that case I would suggest if you did not like that, or it was too onerous to collect (it would not really be any bother from employed persons, but it might be a lot of bother from self-employed), you could have just a flat personal exemption limit at the bottom.

2048. You recognise in your paper that one of your difficulties would be the outside elements of income, would it not?—Yes, but I do not think that is really so very difficult if you have this annual return of income. You would not, of course, have the ingenious method of coding in all those addresses that the Internal Revenue has managed to bring about over the course of years, but although I of course recognise the administrative saving in that I do not like it very much as a system because it is just that that muddles up the taxpayer hopefully as to what he is having to pay when. I would rather see the different items in taxable income set out fairly and squarely in an annual return so that the taxpayer knows where he is and what he has to settle. Under the American system he can either settle immediately and be done with it, or he can settle at the end of the year, and if he does not settle within 30 days, he has to face interest on his overdue payment. I would like at this moment to emphasise that I think it is a very good system to make people pay interest on tax arrears. It may seem tough on our ways of thinking, but when income tax rates are as high as they are both persons and businesses have the incentive to get an undeserved tax free loan from the Internal Revenue by putting off their payments to the last possible date, and I do not see why they should do it.

2049. It really depends on whether those who are going to assess the tax can give an administrative service which makes it possible for taxpayers to pay their tax at the due date.—Yes, but so long as their liability has been ascertained then they should be forced to pay it on pain of a fairly stiff interest charge.

2050. I am still not quite clear. If you were working by the proportional tax for wage incomes, let us suppose a person who is paying his tax in that way has some smaller outside income which is subject to deduction of tax at source, at what rate should he suffer deduction of tax under your system?—That would depend on his overall income, would it not? If he were in the range of simple tax only then presumably he would not pay any more than that. If he were in the range in which he also got income tax as a sort of surtax then he would pay whatever rate was proper to that. I think it would be open to the Commission to make alternative suggestions on that. I think it would perhaps be difficult to get a higher rate out of him such as, say, the lowest rate of income tax even simple tax when he was below the income tax exemption limit. I do not know how much revenue might be lost from that, but I would not imagine very much.

2051. Perhaps not. I do not want to vex you with administrative difficulties, but what was troubling me was that if he was a person who did not reach the higher

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income level, the person paying the amount due to him, and deducting tax at source, could not know whether he was or was not in that class, and therefore would have to deduct tax at some conventional rate.—He would have to have a bill from the Inland Revenue effectively.

2052. And the man, if he suffered deduction at the standard rate, and was not liable at the standard rate would have to make a repayment claim?—He would.

2053. Whereas today it gets coded in normally under the P.A.Y.E. system.—Yes.

2054. Then you pass on to some suggestions, rather generally, as to whether the higher incomes could not be all placed on the current income basis, that is your theme?—Yes.

2055. And you draw attention to the fact that a taxpayer having income from various sources may, under our present system, find two or three different years by which his income for the year in question is measured?—Yes.

2056. Would you apply this to taxation of company profits? After all Schedule D, the assessment of business profits, is the greatest malaise I think of income which is assessed on a past year basis. Do you want to change it to a current year basis for business incomes?—On the purely economic ground, from the point of view of keeping in line with changes in the national income it would be nice to do so, but I am not sure that it would be administratively practical.

2057. You are thinking more of the personal element?—The personal element. I do not know whether it would be, but if it were administratively practical I think there would be a lot to be said for taxing firms on current expected profits. In the U.S.A. the problem is different in a sense because the corporation tax, the company's tax, is a separate tax from income tax.

2058. Have you in mind that when you speak of applying a new system to higher incomes everyone would be under the proportional tax for the first slice of his income?—I think that would be the simplest method.

2059. And then, in so far as your total income exceeded that then, you would pay by what you say are a series of progressive rates with no standard rate?—Yes, what the Americans call our "platform", standard rate, as such would disappear. There would be no big step at all but rather a series of small steps as in the present surtax range.

2060. One of your difficulties would be, would it not, that if you maintain our system of deduction of tax at source you would not know what rate to deduct the tax you were withholding, would you?—You would, because though you do not have a big platform that does not prevent you choosing a particular step for this purpose. In fact it would give the Chancellor much more freedom I would have thought in choosing the rate of deduction that he thought would be most appropriate. What you would want to get, I take it, would be something that would enable you to collect a really big whack of income tax from people without giving rise to too many refunds to people who in fact turn out to be below the level and so have suffered overdeduction.

2061. At present, of course, you always deduct at the standard rate, and if a person is not liable to the standard rate on his whole income he makes a claim?—He claims a refund.

2062. Under your proposed system there is no standard rate, there are a series of steps up as your income goes bigger and bigger. You just have to . . . ?—Declare that one is the standard rate.

2063. Just declare that for the persons deducting and have it?—I cannot really see that there would be any difficulty in that.

2064. Chairman: I think those are all the questions I wanted to ask you about your proposals with regard to income tax. I daresay some of my colleagues would like to deal with that before we come on to another branch of your paper.

2065. Mr. Millard Tucker: Mrs. Hicks, your suggestion is I think that all incomes should be put on the current basis?—That is what I would like to see.

2066. Have you read the Report of the Committee on the Taxation of Trading Profits* on this topic?—Are we talking about personal incomes or all incomes?

2067. Among the incomes you are speaking of will be the small business man's income?—Yes.

2068. As well as the large company?—Yes.

2069. And the large companies are very much in the minority in numbers?—Quite, yes.

2070. I cannot recall the exact figures in my head, but I think that out of some one and a half million payers of tax under Schedule D is respect of business incomes only about 200,000 are companies?—Yes.

2071. The remainder are individuals?—Yes.

2072. Or partnerships?—Yes.

2073. This matter of moving the basis for assessment of those types of earnings was adumbrated before the Committee on the Taxation of Trading Profits. I wondered whether you had read the Report of that Committee which examined the position in detail and came to the conclusion that it was not practicable?—It seems to be practicable in other countries.

2074. It certainly works in America, we know that?—But not only in America, in Sweden.

2075. I will not go into all the objections to it, but I would have liked you to have read it and then answered it.—I am afraid I do not recollect exactly well, although I have read your report.

2076. One of the difficulties, of course, not from the point of view of the taxpayer but from the point of view of the Government, is that the job of estimating is not so good. At the present moment the Chancellor has a rough idea of the total amount of income upon which he can charge a particular tax, and then he has only got to fix the rate, to estimate roughly the yield from that part of the tax?—He would still have a rough idea, because he would still have his returns. It might be a bit rougher.

2077. He would not have his return if we are going to remain on a fiscal year which begins on 6th April. When would you suppose the people would have to send in the return for the year beginning on 6th April?—According to the American system they send it in I think it is three months after the beginning of the fiscal year, so that he would have nine months before the Budget an estimate of the income that he would get during the year, and I should have thought he could make a pretty good guess with the aid of other income estimates.

2078. Of course, with regard to wages and salaries, I think that is the main part of your first portion of the paper, is it not?—Yes.

2079. Your objection is I think merely that the present system is what you describe as disincentive?—Yes.

2080. Is not that it?—That I think is a major objection, yes.

2081. The others are quite minor, are they not? Is not that the major objection? I think it is with most people?—Yes.

2082. And, having read your paper carefully, is that because it encourages absenteeism? The taxpayer gets as a rule an actual refund in money of previous tax deducted?—That is, I think, an important thing in the wage range.

2083. And the other is that there is a distinct discouragement to him in undertaking overtime work?—Yes, and in making additional effort altogether.

2084. It would compare, I suppose, with the high surtax payer who is about the fourth or fifth months of the year says, "I do not think it is worth earning any more this year".—Yes, I think it has also a long period deterrent effect. It discourages people, particularly when a little extra would put them into a higher tax step, discourages them from further specialisation, education, and so on.

2085. Leave out the surtax payer for the moment. Would you tell us if you have ever met any work people who have told you that they have deliberately refrained from agreeing to work overtime because they will pay, say,

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9s. in the £ to the Government?—Yes, a number of times I have met people who have said that to me. "It is hardly worth it because of the tax". That is what you hear again and again.

2086. Are you sure that you really hear that from the majority of people?—I am not a person who goes around specifically talking to the workers. It is just really what one hears mainly of people who work for one and so on, so that I could not be said to have a large experience, but I would say it was pretty general as far as it goes.

2087. Why I asked that is because we have been told this over and over again by people.—Yes.

2088. And when we ask how many people they have ever heard who have said it we find it difficult to get any real information about that.—To get a lot of information you would have to have a survey I imagine.

2089. Some of us have some actual practical experience of work people and from our own enquiries we are not at all satisfied that the feeling is so widespread as we are told it is. How we are going to discover the actual facts I do not know.—Does it matter just how widespread it is so long as the case can be established that it exists, and that this case could be removed by a reform of the tax?

2090. We have to set that against a lot of administrative difficulties, have we not?—A path leading in the end to administrative simplification.

2091. I am asking you why you thought that income should be based on the current earnings since that is in fact the case with regard to wages and salaries.—Yes, I know.

2092. In fact it is the case with regard to the bulk of dividend income even including some of the dividend income drawn from foreign sources. It is the case with rents, and it is the case with annuities.—Yes. It is because I like that system that I want to reform the Pay As You Earn system so as to enable one to retain the current basis or even to extend it and to remove the disincentive effects at the same time.

2093. That is why I asked you. That is the only reason why you suggest some modification of the present P.A.Y.E. system of deduction, those two outstanding objectionable features?—I think some of the minor objections as you call them are fairly serious ones, the burden thrown on employers of operating this enormous collection of complicated codes and the weekly cumulative tables.

2094. Again, Mrs. Hicks, are you speaking from personal experience?—Obviously you have on the Commission people who can answer that better than I can, but surely it is the case....

2095. I would like to test you on it, if I may, because some people without experience have rather distorted ideas about it. How many staff do you think the average employer would have to keep to look after P.A.Y.E. deductions of, say, a thousand men?—I have not the slightest idea but that you would have to get staff and people would have to write books and make machines for P.A.Y.E. and that sort of thing, is obvious. Then there is the further business of the rigidity of codes and tables once established, although I understand that that is now quicker than it used to be, but there was a very long time lag during which you could not change your tax because you could not get your codes and tables calculated and printed.

2096. Can you tell me with regard to the higher income tax payers how far the steeply rising rates affects their output?—Of course, it is very much more subtle there, because it is rather a question of quality than quantity. There is not any extra income to be ascribed for extra hours of work, it is rather intensity of work. In the case of academic people that is different because you can vary your income very simply by taking an extra job, or not taking one, that is freely done and they may say, "What is the use of writing an article when I only get less than half of the pay".

2097. You think that feeling is widespread?—I should think so and certainly I reckon I have it myself.

2098. Mr. Millard Tinker: I was not going to ask you any personal questions at all. Thank you, Mrs. Hicks, that is all I wanted to ask.

2099. Mr. Woodcock: Just a few questions. In paragraph 13 you say there are two minor objections to your simplified system for the weekly wage earner?—Yes.

2100. And one is that "The element of progression now obtained at the lower end of the structure by the operation of flat sum allowances would be lost"?—Yes.

2101. Do you consider that only a minor objection?—The difficulty about this simple tax business, of course, is that it would only be proportional at the lower end, but on the other hand it would be a simple tax which could be levied at a very much lower rate than the present, so that in fact the family man who has a fairly low income would probably benefit, or a system could be made in which he would benefit considerably.

2102. Of course, he could benefit now if the tax rates were reduced.—He could benefit now if the tax rates were reduced, but that would mean putting more on other people unless you reduced them overall.

2103. Is not that the point? If within this range you were to fix the rates in relation to the least well-off man then compared with the present system the man at the top of your range is getting an advantage.—That is true, and if that were important you would have to bring down the income tax exemption limit if you were losing too much revenue or giving him too much advantage.

2104. You would have to restore some of the element of progression.—Bring down the income tax exemption limit, but that would only be at the top end of the wage scale though, of course, it is true that you would have to be careful to readjust the exemption limit if you got a further serious inflation otherwise you are going to lose a lot of revenue.

2105. It means then from what you say here that within the range that it operates, however small that may be, within that range it is less equitable than our present system?—One has to consider also what is being done about the social insurance payments. At present they are a highly regressive flat sum tax. If it were possible to make them into a proportional tax then you would be removing a regressive element at the same time as you were removing a progressive element and so I think it would not come out too badly in the wash.

2106. On the assumption that social insurance contributions are a tax?—Yes, that they are a tax. I do not think we need bother to go into that. In fact, they are a compulsory flat sum contribution.

2107. Is a trade union contribution a tax?—It is not legally compulsory is it?

2108. No, but it is a flat rate contribution.—The social insurance contribution is legally compulsory.

2109. For a special purpose.—For a special purpose, yes.

2110. It is not equally legally compulsory. Some people pay different rates for different benefits.—Broadly speaking it is.

2111. Anyhow your point there is that the social insurance is based on the assumption that it is the equivalent of a tax?—Yes.

2112. But we had that before.—Yes.

2113. It is not only inequitable within its range but to that extent it would have an element of inflexibility. It would restrict the Chancellor's power within that range to raise tax.—Why? What he would do would be to alter the rate of the simple tax.

2114. The extent to which he could raise the proportional tax which would be essentially a flat rate tax would be the extent to which he could in decency tax the lowest of the persons in that group.—Yes.

2115. He could not, in other words, fix this simple tax at a rate which would be appropriate to the highest in the range.—I think he would have to choose some sort of compromise then as I suppose he does now with family allowances. It would always be possible to extend the system of allowances given separately of course.

2116. Allowances for personal circumstances, not according to the amount of the income.—Yes, they are for needs, but then the progression which is now obtained in the lowest range of income tax depends entirely on personal circumstances.

2117. Surely it depends upon the amount of income?—The amount of it does, but it is not a progression in the rate of tax, merely in the incidence of the allowances.

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2118. The progression is surely in it. Of course, I do not quite know how your system would operate. You speak of putting it up to somewhere between £450 and £600.—Yes.

2119. Even £500 is not low, but I do not know where you would really stop. You might in fact cover some people who move from one rate of tax to another rate of tax within your system, or at least you might be covering within your system people who were paying now at two different rates of tax.—Yes, but while a taxpayer may be paying at two different marginal rates, when averaged he is paying at only a single effective rate.

2120. No, paying two different rates, 3s. 6d. or 5s. 6d.—These are the marginal rates, if you average 3 over the whole income, you can express it as a percentage of income.

2121. Yes, but the point is that it would be less flexible.—Yes, within the tax system it would be less flexible. The Chancellor would have to introduce the flexibility some other way.

2122. The second point is that you would not be able to include miscellaneous items. You have no idea, I suppose, of the work that would be caused by the later adjustment to take account of these things, or do you propose that they should be ignored?—Which miscellaneous items do you mean?

2123. In your phrase here you say "The miscellaneous other items, allowances for tools, small property income not tax deducted, mortgage interest and so on, would have to be separately tackled".—Yes.

2124. That is obvious, it would have to be separately tackled.—No doubt for the allowances for tools or industrial clothing if it were considered necessary to confine them. I am not convinced that it really is. If an industry requires particular tools or something why should it not pay for them? Even if it were necessary to continue these they could be very easily regarded as a small percentage allowance. If you are having your allowance on a percentage basis you can put in a small allowance for tools.

2125. I do not know really whether it should be allowed or not, but have you any idea of the work that would be involved in making these adjustments, or making adjustments for that?—I cannot see if you are working a percentage allowance system that there will be any extra trouble in allowing, say, 1 per cent. for tools and adding up your percentages to get the total allowances.

2126. Allow the same percentage all through?—Within the range of the simple tax.

2127. That would be very costly as compared with the present allowance.—Make it smaller then.

2128. That would be unjust then to people who would not get the allowances but are supposed to be entitled to them.—I can imagine other ways that the thing could be worked. You could have a flat rebate if you like at the end of the year. At present not everybody claims their tools allowance.

2129. Not everybody is allowed it, not everybody has a right to claim?—Yes.

2130. And some have a substantial claim. All these rates would have to be made into one single straightforward percentage or flat rate.—No, if there are single industries that have allowances for tools and you thought it necessary to continue these allowances, remembering that these shops would probably be paying less tax than on the present system, I do not see why you could not have a simple percentage allowance in those industries.

2131. No industries as far as work people are concerned have allowances for tools.—No, work people working in particular industries.

2132. Work people working in particular crafts, covered by a particular union, or association.—However the thing is organised it should not be so very difficult.

2133. I was wondering about the complication with these allowances.—What I had in mind was that where it was necessary to continue the allowance for tools that it would be allowed for those people under a system of a percentage rather than a flat allowance. That seemed to me the simplest way. Of course, what the Americans do is just to give a flat 10 dollars, or some such sum.

2134. What I am suggesting is that to do that would be unfair, it would be costly to give a flat rate all round, and then if you are to do what we are doing now, to try and fit tax all round to personal circumstances, you would still have under your scheme a great deal of additional work though you might save some work.—The work would be different. It is difficult to say straight off what might be saved. Going on from that point it could, of course, be met by certain trade unions being able to claim an allowance similar to a family allowance, a tool allowance I should have thought.

2135. I do not think it could. Anyhow I think I have your idea on that point.—There is the question of small subsidiary income, of rent, or saving certificate interest, and so on.

2136. You could not have a flat rate there, of course.—How do you mean, you could not have a flat rate?

2137. People have different incomes from saving certificates.—There you would get that in the annual return and either it would have been withheld, or people would have to pay the proper rate of tax on it.

2138. Compared with the money paid already in your proportional tax.—Yes.

2139. It is really a minor point, of course. These are what you would call minor objections to your scheme. Of course, your scheme is put forward on the assumption that there is something wrong with the present scheme of P.A.Y.E. for wage earners?—Yes.

2140. And I gather from your answers to Mr. Tucker, indeed from your memorandum, that the main objection to P.A.Y.E. is that it has a disincentive effect?—Yes.

2141. If it did not have a disincentive effect, would there be any point in changing it for your scheme?—I do not think you could ever prove whether it has, or at any rate you cannot establish the extent of the disincentive effect because you have nothing but what people tell you. You cannot get statistics of the amount of absenteeism due to this cause only. It is in the nature of things impossible, but if it is pretty obvious in principle that there are disincentive possibilities or potentialities I would say that was a strong case for trying to get away from it, and I think there would be the further advantages of simplification and greater flexibility.

2142. Of course, you know the history of P.A.Y.E. I assume?—Yes.

2143. You know we had a system of deduction of tax from wages?—Yes.

2144. With a lower limit?—Yes.

2145. And you know that that was most unsatisfactory?—Yes.

2146. You know that that caused a good deal more trouble than any of the trouble alleged to have been caused by P.A.Y.E.?—Yes, I think it did not operate very long and there were other unsatisfactory things. It was during a period in which a great number of people were being subjected to income tax for the first time and their reactions were undoubtedly very bad and would have been very bad to any system.

2147. It operated in the most favourable time for a scheme of that kind, because you paid in a subsequent year on your earnings of the previous year?—Yes.

2148. And it was a time when the whole earnings were going up considerably.—True.

2149. Despite the fact that it operated during that period when there was in general an increase in incomes it caused so much trouble that we had to discuss P.A.Y.E.—Yes.

2150. If a system of that kind were operated in a period when wages were stable or declining the difficulties of that would be even greater.—They would. That is one of my arguments in favour of current taxation in general.

2151. If you want to fix tax finally to circumstances, and to ensure that a man does not pay any more than he is liable to pay, could you improve on P.A.Y.E., apart from the disincentive effect?—No, I think it is terribly clever, too clever by half.

2152. Your real objection to it is the disincentive effect?—And as complication and its rigidity, and I must say that it does seem to me an expensive system. I think that there should be very considerable administrative savings both for the Inland Revenue and for firms.

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2153. At a cost of fairness?—I think you could get fairness in to a large extent by direct allowances. This is assuming that you could not put the insurance payments within the system. If you could and people did not have psychological reactions, that should enable you to do it better, but I am afraid it looks as though they do have psychological reactions which makes the pure Rhys Williams system rather impossible.

2154. *Sir Harry Gill:* Mrs. Hicks, in answer to the Chairman you stated that you did not agree with the repayment of tax during sickness and unemployment because of its disincentive effect?—I do not think I put it in that form. It is obviously a part of the P.A.Y.E. system, you must do it, but I would rather have an allowance directly paid out for someone during sickness. He has an allowance during unemployment. I do not see why you should not have your payments for people who are in these unfortunate circumstances paid out instead of as tax rebates.

2155. As I understood the Chairman he was putting the position to you that repayments are made of tax during these particular periods to some people?—They are what?

2156. They are repaid to people during these periods.—Yes.

2157. And I understood you to say that you did not agree with that because it had a disincentive effect?—Yes. I think the current repayment does have a disincentive effect. In my system, if I may call it so, tax liability would be evaded up at the end of the year, and they would get their refund at the end of the year for any overpayment. They would not be any worse off over the year as a whole under this system, and they would also have their social insurance payments during unemployment or sickness.

2158. Following that I would like to ask you was that idea of yours based on any direct knowledge of facts, in effect where a man or a woman stayed off in order to get a tax return?—I have already answered that as well as I could, I think. I think it was to the Chairman, that I myself have not ever made any surveys of these things.

2159. You have no direct knowledge?—The only direct knowledge I have is rather on the lines that people are unwilling to work overtime, that sort of aspect of disincentive rather than to stay away from work.

2160. In paragraph 12 you say it would be as obvious simplification to include also the present social insurance contributions within the scheme.—Yes.

2161. Is that suggestion based on simplification alone? It is a vital change from the present system.—Yes, and as such I am afraid it might not be acceptable. You see it would have great administrative convenience, and it would get away from that flat proportional payment which Mr. Woodcock will not allow us to call a tax, which is really very regressive. I am trying to think of the progression in the overall (if I may use that horrid words) position. At present the low income bracket taxpayer gets progression into his income tax, through the operation of flat sum allowances which are a larger proportion of tax liability in a low range than in a high one, and on the other side he has to pay a flat sum payment which is a larger proportion of a low income than a higher one. Under the full alternative system his income tax would be flatter because it would be only proportional, it would not be progressive, and his social insurance contributions would cease to be flat. They would also be proportional.

2162. In other words, you do not agree with a flat rate contribution for a flat rate benefit?—Looking on it as a tax, we do try to get away from regressive taxes, and that is a very regressive tax.

2163. But at present it is not looked upon as a tax, is it, it is a contribution for certain benefits?—Yes, it is not of course anything like the full contribution to cover those benefits.

2164. Then you would feel that a man with the same family circumstances for allowances, who has a wage of £10 a week, should pay twice the contribution that a man of £5 a week should?—He has much more taxable capacity, has he not?

2165. Yes, but, as I pointed out, at present it is not a tax, it is a contribution for a certain benefit.—It is so regarded, yes.

2166. To the extent that it is changing the old system from a flat rate contribution to a tax, you would agree with Lady Rhys Williams, in principle?—In principle, yes.

2167. Not in detail?—I think one cannot press it. If people want to pay a flat rate contribution, who is the Government to say that if people like paying a certain regressive tax they should be stopped from doing so, because on the whole it is very hard to persuade people to pay regressive taxes.

2168. *Mrs. Austey:* I am rather worried about this question of administrative expenditure, and I just want to get one point clear. You do really contemplate a universal return of annual income by everybody?—I think it could be of an extremely simple nature. In the weekly wage earning class you would really not need it unless there were some supplementary income, savings certificates interest, or something like that.

2169. So you contemplate some way of asking wage earners to state their income. How would you find out which had those supplementary sources of income, without asking for a universal return?—You might have to. The Americans do ask for a universal return.

2170. Yes, but from our point of view, if that was very costly, and I do not see how it could be avoided, it would be a very serious matter.—I think you probably would have to have a return, but you do have to have a return from people anyway, to know how many babies they have. You see, you are already asking people to make certain returns.

2171. *Chairman:* I did not quite follow what returns you had in mind.—They have to make a return of what allowances they are entitled to, they have to say what their family circumstances are, and if those change in the middle of the year then they have to make a further return. Of course, on that matter, one of the objections which has been made against this simple tax is that it would cut across the business of what you do when family circumstances change in the middle of the year, because at present the allowance is reckoned all the way back to the beginning of the financial year when a new baby is born. I really do not see why that complication should be allowed. Why not only get an allowance for the baby when it arrives? If it is a simplification, it is a great hardship.

2172. *Mrs. Austey:* I hoped you might have some way of avoiding this great difficulty. I find that a great difficulty, myself. Do you suggest that the additional expense involved in that way would be counterbalanced by the saving? That was your argument?—Yes. I should not have thought that the additional expense need have been very heavy, because you can have a very simplified form, not much more complicated than the one now revealing family circumstances, and you can discard at once all those who answer "No" to "Income from interest", "Income from savings certificates" and so on, and it might well be worth while neglecting these items as reckoning taxable capacity unless they came to a sizeable amount; the tax lost would be negligible.

2173. Just one other thing on this disincentive action, and also P.A.Y.E. in general. Do you find that opinions have changed over a period of time, particularly with regard to P.A.Y.E.? I quite see the very great administrative difficulties and the objections at first, but is there not reason to suppose that these have become much less as people have become accustomed to it, and perhaps similarly with the disincentive of the high marginal rate of taxation? Of course, people complain, but do they do more than complain and, particularly when the cost of living is rising, is it a really important factor? Is there not less complaint about that as people have become accustomed to the whole system?—Of course, I think that the impact effect of a tax is always more than the subsequent effect, but I do not think that is an excuse for going on with a system which could be remedied. I think employers have now got their tax departments and their P.A.Y.E. machines, and so on, and in a way they have taken it in their stride, but, at the same time that is a real cost in real terms. Those people might be doing

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something more productive if a simpler system were established which would throw a less burden on them, and I still think there is an important long period element of disincentive in which people just will not be bothered to train themselves for better work because it would put them into higher income brackets.

2174. Do you think that is as important as the actual high rate of taxation? Is it not all mixed up together?—Yes, and if you can get a system which avoids them, I am for it.

2175. *Sir Geoffrey Heyworth*: Is it one of your points in connection with the P.A.Y.E. system that the majority of the tax payers do not know in fact how much tax they pay?—With the mixed incomes, yes.

2176. No. Take the straight forward case of a man who has no other income than wages, is it your view that under the P.A.Y.E. system he will not always know what he has paid at the end of the year?—I do not think it matters for him, he has liquidated his obligations at the end of the year.

2177. That is the point I really wanted to get at. Is the point with which you are concerned, whether the Revenue collects enough, or that the taxpayer appreciates exactly what tax he has paid?—When I was talking about that I was thinking of the taxpayer with the mixed income, not the wage earner, because for the weekly wage earner, as I see it, it does not matter to him in a sense what he has paid at the end of the year, what is done cannot be undone, and if he has not been brought completely into equilibrium. . . .

2178. I do not think I have put the question quite rightly. All I am trying to get at is, do you think it is essential to any tax system that the taxpayer should know how much tax he has paid?—No, I do not think one can say that. Nobody has the slightest idea how much tax he pays on tobacco.

2179. So you do not think it matters that he does not know, in the area of income taxation, whether he has paid £20 at the end of the year or £40, or ten per cent. of his income or 40 per cent.?—I have never thought of that problem in relation to income tax, but I do not see why he should have to know income tax precisely and not have to know tobacco tax.

2180. I would suggest that it is easier for somebody to calculate how much tax they are paying on tobacco than under P.A.Y.E.—The point I have in mind about want of knowledge about income tax liability is the difficulty of knowing what balance to keep for it.

2181. That is your point? I wondered whether you thought it was bad in fact, anyway?—Not specially.

2182. On this question of the proportional tax, you say that it is desirable to have a proportional tax for disincentive reasons, quite apart from administrative difficulty; where do you think ideally the division should come? How would you describe the people who should fall into the proportional tax and those in a progressive tax?—Of course, I think that ideally you would want to include as many people paid by the week as possible, because what you want to get away from, as I see it, is the effect of P.A.Y.E. on the wage earner who is paid weekly. For the man who is paid monthly or *a fortiori* quarterly, it is much more difficult to think in terms of: "If I do a little extra work today I shall have to pay more tax, there will be less in my pay envelope a month hence", so that it is primarily as a simpler method of tax on people who are paid weekly, that I would envisage it. But of course the other limitation is the extent to which you could afford to sacrifice revenue by keeping on that proportional tax as the sole tax on income into the rather highly paid wage earning ranges, in fact you could not. Up to the top people, obviously, you would have to have some sort of supplementary income tax, let us call it surtax, with progressive rates on top of the proportional tax, but the people who would be subject simply to the simple tax would be as near as you could get the bulk of the weekly wage earners.

2183. Actually the position is that if you approach the thing from the point of view of principle we find in the second part of your answer that you cannot do that wholly because of administrative and other difficulties, so

you have to have some mixed area, you cannot get the two things exact.—You cannot get the upper limit of simple tax ready to cover weekly wage earners.

2184. Just one final question, arising out of your remarks on the desirability for close relationship between the tax and the national income. The scope for that, I take it, must lie very largely in the surtax field, is that right? In other words, nearly all income tax at the source is in fact on the basis of the current income, is it not?—Yes. But of course direct earnings are not.

2185. Direct?—Earnings, other than P.A.Y.E.

2186. Of individuals?—Yes.

2187. You mean the self-employed person?—The self-employed person, or the person who gets royalties, and all that.

2188. Nevertheless, the big gap to be closed in this lack of correlation is in the surtax field?—Yes, which of course nowadays is a very big field.

2189. I think your only observation on the current basis of this tax and surtax is indirectly in paragraph 19, where you refer to the American system?—Yes.

2190. You do not make any comment. Would you like to make any further comment on paragraph 19, relative to the United Kingdom?—No, not further than that if other people can achieve full current collection I do not see why we should not, and I think there would be very considerable advantage in trying, but in the meantime the Inland Revenue has produced a memorandum* on that which makes it look as though there might be complications. One can think of answers to most of them, I believe.

2191. *Chairman*: I think that is all the Commission would like to ask you on the part of your paper dealing with income tax. Now I have one or two questions. I would like to put to you about your Part IV, on capital gains; only one or two questions, because I gather after your discussion of this question you do not advocate bringing capital gains as such into the scope of tax on incomes and profits?—Quite, that is true.

2192. What I would like you to help me on is to point out what I am to think of as being meant by a capital gain. In your paragraph 34, are you thinking of this: any asset belonging to a person which is not held by him for the purpose of realisation may either go up in value without being realised or may in fact be sold?—Yes, broadly speaking, though there is of course the marginal case of the man who buys a Stock Exchange security hoping that it will go up and that he will have a capital appreciation, but he will also have dividends off it; I have in mind here the man who is just trying to do the best he can with his investments without being a regular speculator. The Inland Revenue surely has to draw this distinction in any case between the man whose business it is to make capital gains and the man who makes the occasional casual capital gain.

2193. If we are to think of a man whose business it is to use his resources to make a profit, then you would envisage him as within the scope of income tax today, would you not?—Just as he is today, no change.

2194. Therefore we have got to think of somebody who does not make it his business to do that, but who owns an asset of any kind, it may be stocks and shares, or land, or pictures, or any other object of value. If in a year that object goes up in value, is that what you call a capital gain?—That would be an unrealised capital gain.

2195. If it is unrealised, it is merely that you assume a market value and you find that set against the market value it has a greater value?—Yes, and he can use that greater value if he wants to get an advance on it.

2196. Ought one to speak of that being a gain, without looking at the state of his other resources which he holds?—He may have gained on them too, of course.

2197. Yes, but what I have got in mind is this, and I want your help on the theory of it: supposing he has three kinds of asset which he holds, and one goes up five per cent. in market value in the course of the year and the other two go down five per cent. in value each in the course of the year; has he got a capital gain in the

* Not reproduced in these Minutes of Evidence.

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[Continued]

sense one must use the phrase, because one has gone up in value and two have gone down?—It would be fairer to measure his net gain or loss over his whole possessions.

2198. That would mean you would have to take something like an account of his general position as between the beginning and the end of the year?—Yes, exactly.

2199. I suppose the practical difficulty of doing that would be that you would have to give market values to things which are not always capable of market value, and you would have a very elaborate enquiry of everybody's asset position?—Yes, which of course in fact is not practicable.

2200. It may be impracticable?—The Americans have recommended it to the Japanese, and they are supposed to make a personal return. How it will work out the Japanese do not know, of course.

2201. I was just trying to get the theory. That is dealing with unrealised capital gains. I suppose if you are dealing with a realised capital gain, that is, he does in fact sell one of his resources, the gain is the difference between what he gets and its historical cost to him?—Yes.

2202. Ought you to call that a gain without looking at his general position with regard to his other resources?—I do not think you ought, but of course that is the difficulty about capital gains taxation, that it is so difficult to take into account the man's net position. That is one of the reasons why I think they are unfair.

2203. But it is a gain in the sense that we have described, if you isolate it from the rest of his resource position?—Yes.

2204. Then you go on in your paper, which I have read carefully, to illustrate certain difficulties of applying a tax on that transaction. There are changes in the value of money, there is the difficulty of allowing for the fact that people have held these assets for varying times, changes in the interest rates, I suppose?—Yes.

2205. Or forced liquidations, which, although they show a profit in the sense you are speaking of, you think ought not to be the subject of a special tax. But then you end by saying that you think it better on the whole to leave this particular form of operation alone: "It would seem more desirable to continue to tackle the capital gains problem within the framework of the ordinary income tax as it is done at present." What had you in mind there?—I had really two things in mind, one, that the man who habitually trades and makes capital gains should come under the income tax as before, and we have dealt with that; secondly, the case that worries the Americans so, of the personality controlled, what we call the one-man company, which deliberately does not distribute, and then distributes a capital bonus. We do tackle those very carefully within the range of surtax. The Americans do not do that, you see.

2206. You have got in mind those provisions which began, say, in 1922, of a company which is under the control of a limited number of people, which does not

distribute the income as in a business sense it should, and then there is a statutory provision that it should be taken into account for surtax to its members?—Yes, which seems to me as far as one can see to eliminate to a very large extent the propensity to hold back profits, because if you are going to be subject to surtax whether a proper distribution is made or not, there is not the same incentive to hold back profits.

2207. It deals with the case of the person who is using the machinery of a small private company for the purpose of storing up income, it does not go beyond that?—It does not go beyond that, no.

2208. But there are many cases of persons who realise gains in the sense that we have been speaking of, through the obtaining and selling in due course of assets which do not come within the special provisions of that statute at all?—That is quite true, and if they make a habit of doing it then clearly it ought to be covered in the income tax.

2209. That is a question for the income tax authorities?—Yes.

2210. Mrs. Austrey: You refer to the annual tax on capital, but you do not approve of it in the end. You do suggest that such a tax might be considered to be a form of income tax, at least, I thought you did. I would just like to know your views on that?—In the sense that if it is a low rate annual tax, half of one per cent, or something like that, it can probably be paid out of income and so would really be an income tax assessed on property rather than on income.

2211. Would you draw the line or make your criterion at that point, whether it is payable out of income or not?—No, you cannot say whether a thing is payable out of anything any more than you can say how death duties are payable, but whether they are paid out of capital or income depends on the individual position.

2212. You cannot suggest any test on what would then cease to be a tax on income?—If people have the income they pay the tax out of the income, do they not, rather than sell the capital asset?

2213. I was meaning from the theoretical point of view. The difference between an income and a capital tax?

2214. Yes.—I think there are two criteria, one, that a capital tax is of such a large amount that it cannot be paid out of income; two, that it is unexpected and people cannot therefore prepare for it in advance by insurance. A case for all capital levy would come into that definition, and so I think would death duties, because though you can ascertain roughly what you have to pay in advance, you do not know when it will have to be paid. And the statistics suggest that people do not in fact prepare for death duties nowadays.

2215. You think those are the best criteria?—I think these are the only true capital taxes, in the sense of being paid out of capital.

Chairman: Thank you, Mrs. Hicks. I think that is all the questions the Commission want to put to you. We are very much obliged to you for your paper, which has helped us, and for your evidence.

The witness withdrew.

Mr. F. H. HUGHES, called and examined

MEMORANDUM SUBMITTED BY MR. F. H. HUGHES

PART I

INCOME TAX FOR WAGE EARNERS

1. Pay-as-you-Earn has been severely criticised. It has a strong disincentive effect on variable wages, it is obscure to the taxpayer, and both cumbersome and costly to administer. Its main achievement is the collection of the year's tax at the end of the year. Any suggestion for reform must aim at removing the disincentive effect, must be fair to the employee, easy to understand, simple and cheap to apply, and it must ensure a speedy and controlled tax collection. The following suggestions are not concerned "with the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden", which is to some extent a political problem, but with the incidence and the effects of the

taxation connected with the weekly assessment and collection of a basically annual tax; this particular question can be examined purely as a statistical and accounting matter.

The Theory of P.A.Y.E.

2. Any progressive tax unavoidably causes some disincentive effects. In the case of P.A.Y.E. this is aggravated because not only the tax, but also its collection, is progressive and because the progression is applied to the weekly payments. P.A.Y.E. is calculated each week as if the earnings to date would continue at the same rate to the end of the fiscal year. P.A.Y.E. thereby assumes the prerogative of Providence—to know the future. For persons in seasonal employment this is clearly wrong and

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[Continued]

leads to anomalies like repayments of tax or to tax-free periods of employment. For all employees with varying wage payments, it results in taxation at marginal rates.

Income-tax is steeply progressive in the range of incomes which concern us here, owing to the tax-free personal allowances and the three basic tax rates (2s. 6d., 5s., 9s.) as shown in Table 1. It will be noted that the progression is steeper at the lower end, and that the marginal tax rate (basic tax rate less earned income allowance) is in most cases twice the effective tax rate (total tax divided by annual income); at the lower end it is much higher. Under P.A.Y.E., the weekly deduction is the aggregate tax to date less the aggregate tax to the preceding week; any change in the weekly earnings is thereby taxed at 4s. or 7s. 2d. in the £. Permanent changes in earnings immediately attract the correct progressive tax. Desirable as this result is, at the time of the wages payment those changes obviously cannot be distinguished from temporary fluctuations. For these, however, the deductions under P.A.Y.E. become quite arbitrary, since a week's portion of a progressive tax is not defined if the annual income is not known; they have to be compensated by some more erratic deductions in the following weeks. In fact, the weekly deductions are the rate of change of tax, i.e. the differential of the annual tax.

Effect of Marginal Taxation

3. Income-tax is progressive on the grounds that persons who maintain a higher standard of living should contribute a higher proportion of their incomes to the community; but the varying wages payments often cover the same standard of living which is taxed at different rates week by week. The wages are unequal instalments of a fairly stable average income. The deviations can be caused by sporadic overtime or short workings, night shifts, periodical bonus calculation or by varying piece-work earnings. The disincentive effect would be less marked if a previously assessed tax was only collected progressively; but P.A.Y.E. claims not only to collect tax, but to be the tax on the week's earnings, and thereby demonstrates to each employee that 20 per cent. (32 per cent. for 1951-52) (or in the higher income groups 36 per cent.) (38 per cent. for 1951-52) is deducted as a tax burden from his extra earnings; any reduction of a week's wages is mitigated by a reduction of tax at the marginal rate or a tax refund.

4. It is absurd that any absentee should be assured of an immediate tax reduction or cash refund. But more important still is the general appreciation that each pound gained is worth only 16s. or even 12s. 10d., and that for each pound lost he forfeits only 16s. or even 12s. 10d. In a free society effort is controlled by pecuniary award. It is not enough to appeal to men to work harder, to attend more regularly, to go all out for available labour incentives, when every relapse is awarded a tax benefit, every effort deprived of its fruits by the marginal taxation.

Without P.A.Y.E., incentive labour schemes would come into much wider use, not only because they would be more effective, but also because moderately incentive bonus schemes—which are now quite useless—would become attractive and could be set up where a straight piece rate cannot be arranged. P.A.Y.E. constitutes a retarding element in the country's economy. Productivity could be improved if the restraining effect of P.A.Y.E. could be overcome.

Progressive Taxation

5. The progressive character of income-tax cannot be eliminated. Even the proposal of a flat-rate tax contains the mark of progression in the personal allowances. Nor can the average gradient of progression be reduced unless the tax burden is considerably increased for the lower incomes; it would be impracticable to reduce the tax at the upper end of the range, not only because of the loss of revenue, but because of a discontinuity of taxation in the ranks of salaried persons. Such an attempt would differentiate between weekly wages earners and monthly paid employees or self-employed persons and would make a distinction which is alien to our society. The inclusion of the national insurance premium, which is a "poll-tax", would flatten the progression but not extinguish it. Besides, many an argument could be raised in

favour of a separate collection of the national insurance premiums; this point cannot here be discussed further. The following proposals, however, can be applied to the collection of either income-tax alone or of the sum of tax and insurance premiums.

Theory of a Reform

6. The recommended solution is a proportional tax collection, superimposed on a progressive tax. Short-term fluctuations of earnings which are not significant of a change of income would be accounted for by a proportional variation of the tax deduction, while permanent alterations in income would attract progressive taxation at marginal rates. The different causes of wage variations, however, do not provide a means of distinguishing between the two—the only practical solution is the passage of time. The critical period must be a common factor of 52 owing to the peculiarities of our calendar; the choice lies therefore between 4 and 13 weeks. As the former value is rather small, this leads to one practical answer: the quarterly assessment of tax with a proportionate tax deduction for deviations in the next quarter.

7. The assessed tax divided by the income of the period gives the average tax percentage, simply expressed as effective tax rate of s. and d. per £ of weekly earnings. The weekly deduction is weekly wages times effective tax rate. If earnings rise, the collected tax will be proportionately higher than the quarterly assessed tax, and vice versa. On short payments the deductions are proportionately reduced, but there is no tax-free minimum, not a tax refund, the personal allowances having been applied at the quarterly assessment and included in the effective tax rate.

8. As basis for the quarterly assessment the following could be considered:—

(a) The earnings of the previous quarter; this is unsatisfactory owing to seasonal variations; it would give a lower rate at the beginning of the season and a higher rate in the off-season.

(b) The aggregate earnings in the fiscal year, using tax tables for week 13, 26, 39 as was suggested on a previous occasion; it was found, however, that this method causes some complications due to the use of various statistical terms.

(c) The moving annual totals of earnings. This effective statistical device is now recommended. It is very easy to use. In general, it reduces changes of the effective tax rate to the minimum. It gives a perfect fit to seasonal deviations. In case of permanent change of earnings, the effective tax rate is gradually adjusted in the course of one year.

The tax would be assessed quarterly by the employer on the earnings of the last twelve months; the annual tax divided by the income of the period gives the effective tax rate for the next three months. It will be noted that this method can be applied to all and any form of tax assessment, irrespective of type and amount of allowances, of number and amount of basic tax rates. If preferred, national insurance premiums can be included.

Administration of the Proposed New Tax

9. The employee would be informed of his effective tax rate each quarter and could truly check his weekly deductions. He would see clearly that he was paying only 1s. or 2s. in the £—the illusion of a tax burden of 5s. and 9s. would be gone. Each week the wages clerk would multiply the wages, corrected to the nearest 10s., with the effective tax rate and record wages and weekly tax; instead of six columns as at present, only two would be completed; no tax tables would be used.

At the end of each quarter, the wages clerk would add up the wages column, entering the sum in a table which contained the earnings of the three preceding quarters, and arriving at the annual income. He may then apply tax tables A and B of week 52 and divide the tax by the income. But it is simpler to provide a table which gives the limiting values of incomes for each code number and each penny of effective tax rates. In the column for the correct code number the earnings equal to, or first higher than, the income would be selected, and the

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effective tax rate read off in the margin of that row. The annual tax would not be required except for the annual reconciliation, for which case tax tables A and B would have to be consulted.

Staggering of Calculations

10. The quarterly computation would not involve more work than the present weekly calculation and, moreover, could be done at any time between the pay-days of week 13 and week 14. But if it were desired to avoid any peak load, the work could be broken down into three groups, each displaced by four or five weeks, so that in each month one-third of the tax cards were recalculated according to the initials of the employees. Their tax year would be out of step with the fiscal year by not more than nine weeks. A far wider concession of such type exists for the permissible accountancy date under Schedule D.

On change of employment the following information would be required on form P45: date, effective tax rate, tax paid in current year, code number, wages in current quarter and in the three preceding quarters.

Controls

11. After an initial period the new method would not involve a greater risk of clerical errors than P.A.Y.E. The following controls are available.

1. A monthly sub-total of the tax deductions on each tax card. The sum of these sub-totals to agree with the monthly remittance and the sum of the tax deduction totals in the cash-book.

2. A quarterly check of the weekly deductions: the quarterly wages multiplied by the effective tax rate give the proportionate tax liability for the quarterly earnings. A difference, which might be due to the approximation to the nearest 10s. of weekly wages or to a clerical error, to be adjusted in the next two or three weeks by an addition or refund. This check could be made after week 14.

3. Balance between tax deductions and progressive annual tax liability—see below.

The proposed method does not complicate the supervision by the Inland Revenue: the totals of all tax cards should agree with the annual remittance after correcting for the staggering of two-thirds of the cards by one or two months. Audit of individual cards: check addition of wages and of tax deductions, check the quarterly tax extensions, add up the table of the four quarterly earnings and look up the effective tax rates for the moving annual totals.

Incidence of the New Tax

(a) Variable wages within the quarter

12. Variations of wages payments would cause a proportionate variation of tax deductions. There is therefore no disincentive effect. When the quarterly mean of the wages remains unchanged, the deductions per quarter, and per year, will equal the total deductions under P.A.Y.E.

(b) Seasonal earnings

13. When the quarterly averages vary owing to seasonal variations, but provided the moving annual totals do not change over at least two years, i.e. if a person earns in each quarter the same amount as in the corresponding quarter of last year, the same proportionate effective tax rate covers all four quarters and the total deductions during the year are the same as at present; this is the chief advantage of the moving annual totals.

(c) Permanent change in income

14. Permanent changes in earnings will, after the first quarter, gradually change the effective tax rate, until after three further quarters the new progressive value of the tax rate is reached. That means that an employee who obtained a higher income would, for twelve to fifteen months, pay less tax than at present and vice versa, the difference for a change of 10 per cent. of the earnings being 1.2 per cent. of the income or 10.20 per cent. of the tax.

15. The difference D between yearly deductions arrived from a proportionate tax with moving annual totals at each quarter and a single annual assessment as under P.A.Y.E. can be found from the following formula, which is derived from simple tax definitions. It is valid for variations within each step of the basic tax rate.

r = basic tax rate, e.g., $r_1 = 0.25$, $r_2 = 0.45$.

C = personal allowances plus fixed sum for tax at reduced rates, if any, e.g., for a single person $C_1 = 110$, $C_2 = 110 + 25$, $C_3 = 110 + 125$.

q_i = earnings in quarter i .

A_i = earnings in year ended with quarter 4.

$$D = -rC \left(\frac{q_1}{A_1} + \frac{q_2}{A_2} + \frac{q_3}{A_3} + \frac{q_4}{A_4} - 1 \right)$$

It will be seen that $D=0$ not only when all q 's are equal (case (a)), but also when $q_i = q_{max}$ (case (b)). Values for permanent changes are shown in Table II. The most appreciable amounts occur only in the columns of r_1 , which corresponds to an annual tax of more than £56 5s. (£62 10s. for 1951-52); the differences, therefore, do not exceed 10.20 per cent. of the tax.

16. A strong case can be made out for ignoring these differences altogether. A person who can improve his standing should not be discouraged from doing so by immediate progressive taxation. If the increase were not due to personal advancement, but to a more general rise of money wages caused by a devaluation of the currency, there would still be no case for progressive taxation of wages, the real value of which has not at all increased; at least a year's tax of moderate progression should be allowed. If this principle were accepted, the proportionate deductions for each quarter, corrected for errors or approximations as described above, would then constitute the final tax liability, whether higher or lower than the present taxation.

(d) Temporary change

17. A temporary fluctuation of earnings which affects one quarterly mean only would first have the effects as described under (c), but the effect would extend into the next tax year with opposite sign: a temporary increase would in the first year produce less tax than at present; in the next year, more. In total, the deducted tax in the case of such fluctuation, whether increase or decrease, would always be a little less than under P.A.Y.E. That small "biased error" is caused by the three months' time lag; a proportional increase from a low tax level is less than the corresponding decrease at a higher tax level when the earnings return to their old value. Of two persons with the same income, the one who earns his income subject to irregular changes would pay slightly less tax.

Some examples are shown in Table III. The differences are very small for fluctuations up to 20 per cent. Fluctuations of -50 to -100 per cent. result from occasional unemployment; a recurrent, seasonal unemployment would not create any difference (case (b)).

(e) Prolonged unemployment

18. For unemployment of more than three months, the moving annual totals would produce an extended tax-free period with loss of revenue. The formula given for D is not valid for this case, since the tax falls to zero. Under P.A.Y.E. the tax liability depends largely on the dates of the period of unemployment. An example will make it clear: a single person earning £400 per annum pays £46 5s. (£51 10s. for 1951-52) tax. If in the course of, say, three years he were without income during one whole fiscal year, his tax liability for the three years is £92 10s. (£103 for 1951-52). If, however, that period lies from 6th October to 5th October next, his liability is only £46 5s. + £26 5s. + £26 5s. = £99 5s. (£51 10s. + £27 10s. + £27 10s. = £105 10s. for 1951-52). Under the suggested method, without any further adjustment, it would amount to £58 2s. 6d. (£65 2s. for 1951-52), irrespective of the calendar dates of the unemployment.

Annual Reconciliation

19. It may be postulated that the tax deductions of a year should agree with the annual tax assessment. To meet this condition the differences mentioned under (c) to (e) can be controlled and recovered in this way: at the last quarter of the year the tax tables of week 52 would be used; dividing the difference between the tax due and

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the tax deducted by the annual income gives an adjustment to the effective tax rate for the whole of the following year. As such differences tend to change signs as mentioned under (d), the resultant being negative, overpayments should be held over, until it becomes certain that they were caused by a permanent decline in earnings, whilst underpayments should be recovered at half their amount only, the rest being left to adjust itself through the moving annual totals. The alterations of the effective tax rates would not be more than 10-20 per cent. of their value. Hereby, the same amount as under P.A.Y.E. would finally be collected from every employee, except in these few cases where a person ceases to be subject to taxation before the amount is recovered.

Yield of reformed tax

20. It is suggested here, however, that the agreement with the aggregate annual tax as described above, is neither necessary nor even opportune; the differences can be set off against the expected general rise in the yield of income-tax on wage earners, and the proportionate tax based on moving annual totals is fairer to the taxpayer than P.A.Y.E. A rise in wages caused by higher productivity and better attendance would increase the revenue, first proportionally and, a few months later, at marginal rates. An increase of all taxable wages and salaries by 1 per cent. would first increase the yield by 1 per cent. of the tax, i.e., £4.4 million, and finally, by approximately 0.25 per cent. of the taxable income, i.e., £12.415 million.* The loss of revenue caused by the fluctuations of case (d) would not be large even if it concerns a portion of 20 million taxpayers (these figures are for the year 1948-49). The deficiencies for case (c) are the second differences between the \pm changes of the same percentage in Table II (e.g., for ± 10 per cent. married man at 5s. basic tax

rate, it is 3s. per annum). Some allowance must, however, be made for the fact that more incomes are always increasing than declining for an unchanged total wage bill, since the older generation is replaced by the advancement of the younger people.

Adjustments

21. The heavier losses of case (c) can be reduced or prevented by some empirical device like the insertion of a nominal earnings in the moving annual totals, e.g., if the earnings of two or more quarters are nil, or less than 50 per cent. of those in the current quarter, the value of the earnings in the preceding quarter, and only in that, will be assumed to be equal to those in the current quarter, and that value will be used for computing the present and the three following moving annual totals. An employee starting work after prolonged unemployment would then be tax free for three months, and would pay a reduced tax for a further six months, the total being probably slightly less than his present liability, which depends on the calendar date of the entry into the new job. This correction would not apply to seasonal unemployment for which the difference is nil as shown under (d). In the example of case (c) the correction would increase the tax deductions from £58 2s. 6d. to £69 13s. 9d. [£65 2s. to £78 for 1951-52].

Conclusion

22. The incidence of taxation has been discussed in great detail to satisfy the Exchequer that at least the same level of yield of taxation is maintained. The details concern but little the employee or the employers. They should not detract the attention from the advantages which a proportionate taxation, free from restrictive effects, can offer; they should not obscure the claim made for the suggested reform that the tax is fair to the employee, easy to understand and simple to administer.

* Please see also para. 38.

TABLE I

Para. 23

Fishes for 1951-1952

Wages	Weekly Tax			Tax Rate per Pound						Difference between M.T.R. and E.T.R.		
	Single Person	Married Man	Married Man 1 Child	Single Person		Married Man		Married Man 1 Child		Single Person	Married Man	Married Man 1 Child
				E.T.R.	M.T.R.	E.T.R.	M.T.R.	E.T.R.	M.T.R.			
£	s. d.	s. d.	s. d.	s. d.	s. d.	s. d.	s. d.	s. d.	s. d.	s. d.	s. d.	s. d.
4	3 6	Nil	Nil	11	4 5	Nil	Nil	Nil	Nil	3 6	Nil	Nil
5	8 0	1 0	Nil	1 7	4 5	2	2 5	Nil	Nil	2 10	2 3	Nil
6	12 5	4 0	Nil	2 1	4 5	3	4 5	Nil	Nil	2 4	3 9	Nil
7	16 9	8 3	1 9	2 5	4 5	1 2	4 5	3	2 5	2 0	3 3	2 2
8	21 2	12 9	5 4	2 8	4 5	1 7	4 5	8	4 5	1 9	2 10	3 9
9	26 7	17 1	9 8	3 1	4 5	1 11	4 5	1 1	4 5	4 8	2 6	3 4
10	34 3	21 6	14 1	3 5	4 5	2 2	4 5	1 5	4 5	4 2	2 3	3 0
11	41 11	27 4	18 6	3 10	7 7	2 6	7 7	1 8	4 5	3 9	5 1	2 9
12	49 5	34 10	22 11	4 1	7 7	2 11	7 7	1 11	4 5	3 6	4 8	2 6

TABLE II

Difference between proposed tax and P.A.Y.E. of deduction over four Quarters when earnings have permanently changed.

Per cent. Change	Over/Under Payment	$r = 5s. 6d.$			$r = 3s. 6d.$		
		Single Person		Married Man	Married Man 1 Child		Married Man
		£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
Plus 5 per cent. ...	Minus ...	1 2 0	1 15 0	2 6 0	3 7 0	4 10 0	4 10 0
Plus 10 per cent. ...	Minus ...	2 5 0	3 12 0	6 15 0	6 12 0	8 19 0	8 19 0
Plus 20 per cent. ...	Minus ...	4 7 0	7 0 0	9 5 0	12 19 0	17 10 0	17 10 0
Minus 10 per cent. ...	Plus ...	2 7 0	3 15 0	5 0 0	6 19 0	9 8 0	9 8 0
Minus 20 per cent. ...	Plus ...	4 16 0	7 14 0	10 5 0	14 6 0	19 7 0	19 7 0

Deduction of formula for D:

$$\text{Income Tax per annum } I_s = (4/5 A_s - C) \tau = 4/5 \tau A_s - \tau C$$

$$\text{E.T.R. for Quarter 5} = \frac{1}{A_s}$$

$$\text{Proportional tax in Quarter 5} = \frac{1}{A_s} \cdot q_s = 4/5 \tau q_s - \tau C \frac{q_s}{A_s}$$

$$D = \text{proportional tax of 4 quarters, less } I_s =$$

$$= 4/5 \tau (q_s + q_s + q_s + q_s) - \tau C \left[\frac{q_s}{A_s} + \frac{q_s}{A_s} + \frac{q_s}{A_s} + \frac{q_s}{A_s} \right] - 4/5 \tau A_s + \tau C$$

$$= -\tau C \left(\frac{q_s}{A_s} + \frac{q_s}{A_s} + \frac{q_s}{A_s} + \frac{q_s}{A_s} - 1 \right)$$

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[Continued]

TABLE III

Difference of tax deductions over five quarters resulting from a change in earnings of a single quarter, all other quarters being unaffected.

Per cent. Change	Over/Under Payment	r = 5s. 6d.			r = 9s. 6d.	
		Single Person	Married Man	Married Man 1 Child	Single Person	Married Man
		£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
Plus 10 per cent. ...	Minus ...	1 0	1 0	1 0	2 0	2 0
Plus 20 per cent. ...	Minus ...	2 0	3 0	2 0	4 0	4 0
Plus 30 per cent. ...	Minus ...	10 0	16 0	12 0	18 0	18 0
Plus 50 per cent. ...	Minus ...	1 16 0	2 18 0	3 18 0	5 3 0	7 7 0
Minus 10 per cent. ...	Minus ...	1 0	1 0	1 0	2 0	2 0
Minus 20 per cent. ...	Minus ...	13 0	1 1 0	1 3 0	19 0	2 13 0
Minus 50 per cent. ...	Minus ...	3 1 0	4 17 0	4 9 0	9 1 0	12 4 0

Table III is based on $D' = -rc \left[\frac{Q_1}{A_1} + \frac{Q_2}{A_2} + \frac{Q_3}{A_3} + \frac{Q_4}{A_4} + \frac{Q_5}{A_5} - 1.25 \right]$

PART II

THE REPRESSIVE EFFECT OF P.A.Y.E.

The repressive effect of a progressive tax

24. The effect on incentives depends on two fiscal and one social component:

- the gradient of the progression and the resultant marginal tax rate (para. 25);
- the time lag between income and tax (para. 26);
- the personal factor: the "elasticity of demand for income in terms of effort" (para. 32).

The problem can be examined theoretically or from practical experience; the first way is less exposed to fallacies, the second will serve as a necessary confirmation of the theoretical findings.

The marginal tax rate

25. A repressive effect exists whenever a change in periodical earnings causes a change in the effective tax rate (E.T.R.) which is tax divided by income. This is certainly unavoidable under any progressive tax scheme. The differential earnings are always subject to a higher tax rate than the average earnings, i.e. the marginal tax rate (M.T.R.). The difference between M.T.R. and E.T.R. is the basic cause of the repressive effect. The steeper the tax progression, the greater the difference.

The time factor and time lag

26. Any progressive tax aims at discriminating between tax payers who during the same accounting period have different incomes and are therefore required to contribute tax for that period at different rates (E.T.R.). As that principle is applied year after year, it necessarily follows that different incomes of the same person in consecutive periods are subject to tax at different rates and that the change in income attracts tax at marginal rates. The result is as unavoidable as it is unsatisfactory.

There is, however, no merit in aggravating the effect of the marginal taxation by applying the progression to monthly or weekly deductions. In general, the quicker the M.T.R. follows the extra effort, the stronger the repressive effect. This point contains my essential criticism of P.A.Y.E. The objections between progressive taxation and standard of living are examined in para. 41-42.

Personal allowances, tax steps, and the difference between M.T.R. and E.T.R.

27. The progression of Income Tax is mainly due to the tax free personal and dependants' allowances. The reduced tax rates have a similar effect, but to a lesser degree. In fact, they can be treated as additional tax free allowances which apply from a certain level of income; this method was used in computing the formula for "D" (para. 15), e.g. the reduced tax rate of 3s. on £50 is equivalent to an increase of the tax free allowance for the rate of 5s. 6d. by £23.

The introduction of more and narrower tax steps would modify the progression and make it smoother, but would not solve the problem: the repressive effect of the M.T.R.,

due to the personal allowances, remains even within one and the same tax step (please refer to graphs No. 1 and 2*).

Difference between M.T.R. and E.T.R.

28. The differences between M.T.R. and E.T.R. are considerable; they are greater for the Income Tax of 1951-52 than of 1950-51. There is a peak at the onset of the 9s. 6d. rate, but another more important one at the lower end of the scale. The differences increase also with the number of dependants: wage earners who actually pay very little tax have thus a high difference between M.T.R. and E.T.R. The minimum of that difference in the enclosed Table I (para. 23), which ranges from £4 to £12 and from single persons to married men with 1 child, is 1s. 9d., maximum is 5s. 1d. The unweighted average of the same table is 3s. 2d.

The effect of P.A.Y.E. on varying earnings is therefore the same as that of an Income Tax for which all three basic tax rates were increased by 3s. 6d., i.e. to 6s. 6d., 8s. 6d., 12s. 6d. Of the same problem viewed from the point of the incoming revenue, the effect is the same as if the tax would yield approximately £650 million from wages instead of the £219 million collected in 1950.

E.T.R. increased to the value of M.T.R.

29. It is further a fallacy to claim that the repressive effect would vanish if the personal allowances would be applied elsewhere, e.g. as social security cash payment. Firstly, the combination of the full tax deductions and the cash payments in the weekly household budget would in fact still leave the same progressive taxation as at present with all its bad results. Secondly, even if the cash repayments were, quite unjustly, ignored, a proportional tax at an E.T.R. of 4s. 5d. and 5s. 5d. would be a cause of grave discontent.

Cumulative and independent weekly tax collection

30. Under the British system of P.A.Y.E. the variation of the weekly tax deduction at marginal rates operates by calculating the change in the cumulative tax to date (para. 2); therefore it follows that tax is refunded during a period when earnings cease. A comparison of methods of tax collection which are applied in other states (Austria, the British Dominions; Commonwealth of Australia, Canada, New Zealand and Union of South Africa, of the German Federal Republic and The United States of America) however, shows that none of them uses the cumulative British system. But nevertheless, the marginal principle still dominates all above named foreign systems as far as they adhere to collecting tax from current earnings, i.e. all the above named States except New Zealand and the Union of South Africa. Those systems are based on an independent weekly table, similar to the first three columns of Table I (para. 23) from which the weekly tax deduction is computed as if the weekly earnings would represent 1/52 of the annual income. Australia, Canada and the U.S.A. treat the weekly deductions as provisional payments and assess the annual tax in each case through their tax offices after the year end. In Austria and Germany an annual adjustment is made only on demand by the tax payer, either through the employer or through the tax office; in Austria this applies only if the collected tax differs from the true liability by at least 10 per cent.

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[Continued]

In this connection may I quote from the publication of the U.S.A. Treasury Department, Bureau of Internal Revenue, "Your Federal Income Tax", 1950 Edition, paragraph "Refund of Taxes":—

"Overpayment of Income Tax, either by excessive withholding or overestimating and consequent excessive instalments, entitles the tax payer to a refund. While refunds are made promptly as possible, verification and administrative details require time. Do not become impatient. During the fiscal year 1950 more than 29 million tax payers received refunds. The total amount involved was about \$1.5 billions. Despite the tremendous load of work and the millions of sheets of paper which must be examined, the refunding work was completed by June, 1950, some two months after the final deadline for filing the 1949 returns."

Under those foreign systems there is no tax refund during a current period of unemployment nor is any tax that was collected at a higher basic rate made available when the cumulative earnings at a later date fall wholly in a lower basic rate; but apart from these two minor distinctions all characteristics of the marginal tax collection under the cumulative method are present in those systems. The reprieve effect of those weekly non-cumulative (or independent) deductions depends on the gradient of progression of the underlying income Tax, i.e., the amount of tax free allowances and the changes in basic tax rates. If the income Tax is proportional, as e.g., in the first column of the U.S.A. table where the personal allowances have been applied elsewhere, the tax collection is proportional; where the tax is more or less progressive, the weekly collection is progressive in the same degree.

The same criticism applies to the remarks in para. 19 of the memorandum of the Association of British Chambers of Commerce, dated 12th February, 1951. No appreciable improvement would be obtained by converting from the cumulative principle to that of the independent weekly table.

This paragraph supplements para. 2, where the effect of the M.T.R. was solely attributed to the cumulative principle; in fact, Part I was written without knowledge of any foreign system of tax collection.

Tax progression and social security contributions

31. The importance of this question is illustrated by the following figures, which have been obtained partly by interpolation, from Cmd. 8203, "National Income and Expenditure of the United Kingdom 1946 to 1950".

Year 1950	£ Million		
	Wages	Salaries	Total
Employees' Nat. Insur. Cons.	158	58	216
Employers' Nat. Insur. Cons.	131	50	181
Total Nat. Insur. Cons.	296	108	404
Income Tax	219	254	473

The social security contributions have often been considered as part of the direct taxation. If this view is adopted, the National Insurance Contribution, which is a poll tax and therefore regressive, flattens the progression of the weekly deductions; in the lower income groups of single persons, below £4 per week the combined deduction of Income Tax and National Insurance contribution even becomes proportional; for the higher incomes a considerable progression remains. The employees' National Insurance Contributions of 4s. 11d. per week is equivalent at a basic tax rate of 5s. 6d. to a reduction of the personal allowance (see also para. 27) by £58, at a tax rate of 9s. 6d. to a reduction by £34, and to that extent mitigates the effects of P.A.Y.E.

The above description, however, takes only the net contents of the weekly wage packets into account. There are other points to be considered: psychologically, the employee notices solely the rise of his Income Tax deduction at marginal rates. To him income Tax is a burden which he must contribute to the community, the National Insurance Contribution, although compulsory, an insurance premium for which he will receive future cash payments. In fact, the employees' contributions alone do not fully cover even the current contributory pensions and allowances. There is much to be said in favour of this outlook.

Most of the public revenue is expended in services which benefit every citizen, both taxpayers and exempted persons. The amounts of direct cash benefits to individuals out of public revenue are small and conditioned (Public Assistance, Educational Grants). The Family Allowances are a recent exception to the rule. Social security has in the past been based in this country on the contributory principle. As outlined below (para. 37) every step should be taken to increase motive and effort and to fight the outlook of getting something for nothing. Combining National Insurance Contributions with Income Tax would make the social security system non-contributory, and thereby contrast the above idea.

Closely connected is the question of employers' contributions, which should not be allowed to confuse the issue: if that contribution were cancelled, general taxes would have to carry the burden; this would involve considerable re-distribution. If they were retained, no saving on clerical work would be achieved from the alteration.

In conclusion it can be said that the present method partially and imperfectly mitigates the progression of P.A.Y.E. for small incomes. For the proposed reform it is in fact suggested to retain the contributions independently from the proportional tax; the combined effect would be regressive. If, however, the linkage of tax and contributions was recommended, the reform of P.A.Y.E. would still be necessary and would provide a perfectly proportional deduction over all income groups.

The personal factor in the reprieve effect

32. To what extent the marginal taxation effects variable earnings, depends further on the response of the tax payer to the weekly deduction, i.e., to the "elasticity of his demand for income in terms of his effort". Three different groups have to be examined:

- voluntary absenteeism;
- overtime earnings;
- payment by result schemes.

(a) Voluntary Absenteeism

33. This case is theoretically simple, but of great economical importance. The elasticity of demand for income is here certainly large and the reprieve effect is therefore strong. Under P.A.Y.E. the marginal taxation prevents the employee from appreciating the full loss of earnings which he suffers. If a single person with an average weekly earning of say £10 takes two days off and loses £4 wages, he finds his net wages down by only £2 10s., up to £1 10s. is given to him by tax reduction. Under the proposed scheme he would be short by £3 6s. 4d. and would find that he can ill afford to absent himself. Absenteeism on the coal face in 1950 was 14.5 per cent. half of which was voluntary absenteeism (Monthly Digest of Statistics, and Cmd. 7546). A considerable portion of that absenteeism can not be influenced by monetary incentives. If, however, only one-third of those voluntary 7 per cent. could be overcome by withdrawing the tax advantages, it would yield four-and-a-half million tons of coal a year. The combat of absenteeism is one of the principal objects of the proposed scheme.

(b) Overtime Earnings

34. Here again the "elasticity of demand for income" is large, as is shown by the provision of overtime allowance varying from 25 per cent to 100 per cent. The marginal taxation absorbs all or part of that allowance. The employee does not receive the benefit justly due to him for his extra work. No undue stress, however, is laid on this group since overtime is, and shall be, an exception from the law limiting normal working hours.

In Germany and Austria overtime allowances are not taxable, the tax on the basic pay for overtime is, in Germany, limited to 5 per cent. These measures overcome the effect of marginal taxation on overtime, but are complicated to apply in practice and provide no remedy against absenteeism or the effects on incentive schemes.

(c) Payment by Result Schemes

35. For this group the effect is complex since the elasticity of demand varies. Under some circumstances the elasticity is no doubt small, as e.g., the increase of mined coal in the weeks prior to public holidays illustrates. The miner needs extra money and is prepared to maintain

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[Continued]

a very high effort for a limited period. If under proportional tax collection the same effort would yield larger net wages, this would not induce him to greater effort. But this argument applies only to peak periods. For the average effort over the whole year in all industries, which is considerably below the physical maximum, the attraction of greater monetary rewards for extra output would increase production. For some employees the elasticity of demand may be small, for the majority it is still large.

The incidence of P.A.Y.E. reduces the net bonus percentage of any payment by result scheme by the percentage difference between marginal and effective tax rate, i.e., by 10 to 25 per cent. A straight piece rate thereby becomes a regressive piece rate (bonus scheme), a progressive (differential) piece rate is necessary to give a straight piece rate, a bonus scheme is converted into one with a lower bonus percentage. These effects can be, and have been, compensated by offering stronger incentives. In recent years low graded bonus schemes have been replaced by straight piece rates or have been upgraded (high factor Rowan system), differential piece rates have been introduced, additional bonuses, supplementary to existing schemes, have been created, e.g., a general output bonus payable in addition to a piece rate. These measures tend to increase labour costs with rising output and can have some inflationary effect. But I would like to add that the steeper incentive is not necessarily more favourable to the employee. A moderately incentive bonus scheme can, and should, have a lower zero point and accordingly give the same average earnings as a steeper scheme. Industries with high overheads, can well afford progressive incentives, but industries with a large proportion of direct labour and small overheads, find considerable difficulties. If the zero point of a straight piece rate was set high so as to recover the additional clerical work of administering the scheme, the men fell back on the guaranteed time rate. Lower net bonus schemes for which a lower target would be possible, are frustrated by P.A.Y.E.

The reluctance of the Building and Civil Engineering industries to introduce labour incentives can be partly attributed to the marginal taxation. The same applies to small and medium units in all industries, where means for a scientific setting of piece rates do not exist, but where bonus schemes could easily be used. Only 29 per cent. of all wage earners were paid by results in October, 1949, for establishments employing 25-49 persons the figure was 15 per cent. (Ministry of Labour Gazette, October, 1950). From the Census of Production in 1930 it can be concluded that of all employees in industry and trade 9 per cent. were employed in establishment with less than 11 persons, and 22 per cent. were employed in establishment with 11 to 99 persons.

Practical Evidence of the Repressive Effect

36. It has been said to me that the disincentive effect of P.A.Y.E. is a matter of the past, the men got used to it and only isolated cases of restricted output were noticeable. "It would be a fool's deed to cut his income for the satisfaction of dodging the tax. As a man needs a higher income, he had to earn it the hard way and pay marginal tax." This reasoning contains the well-known argument that an old tax is no tax. The acute symptoms have only become chronic; the evil remains. Does it really not matter how little a man is paid for his work, as long as he is paid at all?

A large number of female and unskilled workers are not affected by P.A.Y.E. Wages below 4d. for single persons, 6s. for married men, 6s. 10s. 4d. for married men with one child, are either tax free or have a marginal tax rate of only 2s. 5d. But wages of 4s. 4s. and 6s. 10s. 4d. respectively carry already a marginal tax rate of 4s. 5d.

My own limited experience also contains those "isolated cases": the married woman in charge of a workroom who preferred to work shorter hours after she had observed the variation of her tax deductions on an occasional overtime, thus leaving her workroom without supervision; the craftsmen who asked if they would save tax when their bonus was paid weekly instead of on completion of their job; the lowering of the allowed times of a Weir bonus so as to give some additional incentive; the refusal of foreign workers in civil engineering

to work overtime in an urgent case expressly because of P.A.Y.E.; the breakdown of a straight piece rate for bricklayers who did not reach the starting point.

By the kind permission of the Leeds Branch of The Institute of Cost and Works Accountants who are conducting a Planned Study on "Employee Remuneration and Incentives", I can refer to replies from some of their members to a questionnaire which contained the following question: "In your experience does the incidence of P.A.Y.E. militate against incentive schemes?" The sample comprised highly organised medium and large establishments averaging 800 employees, most of whom were paid by results. There was little definite evidence that output is restricted owing to P.A.Y.E., but approximately one-third considered that it may have some repressive effect. The sample is too small for statistical evaluation and is not representative for the whole country since it was made up from large units in extremely favourable conditions. It is clear to me that the incentive schemes have been adjusted so as to compensate the effect of P.A.Y.E. as stated in paragraph 35.

Full Employment

37. The conditions of full employment place particular importance on labour incentives. The success of this policy will depend on the achieved level of marginal productivity. If the marginal productivity during full employment is equal to, or is the absence of restrictive practices even higher than that at partial unemployment, this policy will be praised as one of the greatest achievements of free men. If, however, the marginal productivity deteriorates, the policy will be exposed to economic strain and will develop inflationary tendencies. A lower marginal productivity will tend to raise the long term average of unemployment.

This warning does not belittle the splendid progress in industrial activity and in social relations that has been obtained in the post war period by planning, by co-operation of all concerned and by special production drives. But all this was achieved in spite of P.A.Y.E. Without P.A.Y.E. industrial progress could be pursued with better results and with less strain.

The proposed reform is to the advantage of employers and employees and appeals for support from both sides of industry. It does not aim at obtaining increased output without extra costs, but at restoring the normal relationship between effort and award undisturbed by artificial restrictions of a fiscal nature.

Possible Increase in Productivity

Per cent.

38. If it is assumed, in accordance with the survey referred to in paragraph 36, that only one-third of those operatives who are paid by results would increase their output after the removal of P.A.Y.E. by, say, 5 per cent., the national output in terms of the national wages bill, as far as it is subject to deductions under P.A.Y.E., would rise by one-third \times 25 per cent. \times 5 per cent. ... 0.5

Extending the use of incentive schemes to a further 30 per cent. of all operatives and thereby increasing their output by, say, 10 per cent., would yield ... 1.0

Reducing voluntary absenteeism of approximately 3 per cent. by one-third ... 1.0

Total 2.5

The total wages bill in 1950 was £4,470 million, on which £215 million or 4.9 per cent. Income Tax was paid. Of these wages about 35 to 40 per cent. were either tax free or subject to the lowest reduced rate (M.T.R. 2s. 5d.) leaving £2,300 million subject to the higher rates of P.A.Y.E. The percentage of 35 to 40 is arrived from details published for 1949.

Income Range	Amount from all sources	Income Tax
Under £250	£2,309 million, 38 per cent.	£24 million
£250-499	£1,546 million, 62 per cent.	£186 million

Provided that the distribution of wage earners between the lowest two groups of income ranges is the same as of the total population.

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(Continued)

An increase in the productivity by 2½% for those persons who pay the higher rates of P.A.Y.E. would therefore create £67 millions or almost one third of the tax collected from wage earners. The revenue would thereby increase at marginal rates of say 25%, yielding £17 millions.

The above figures have been carefully selected and are probably as under-estimates. The tax free incomes have really twice been allowed for: in the number of employees ($\frac{1}{2} \times 29 \times 5\%$) and in the wages bill (£2,700).

PART III

ANALYSIS OF THE PROPOSED REFORM

Proportional taxation of fluctuating earnings

39. It was shown in Part II that a proportional taxation at periodically revised rates would have marked advantages for the national economy. It was set out in paras. 12 to 21 of Part I from the point of view of the Exchequer that the proposed method would at least yield the same revenue as P.A.Y.E., and in paras. 9 to 11 that the administration of the scheme would be simple. It remains now to examine whether it also pays due regard to the interests of the tax payer.

What is the best way of collecting tax from fluctuating earnings? Three possibilities exist:—

- (a) equal deductions irrespective of the weekly earnings;
- (b) deductions proportional to the weekly earnings;
- (c) progressive deductions.

Case (a) corresponds to the method used prior to P.A.Y.E. when the tax due on last year's income was deducted during the following 10 months. The proposed case (b) is therefore an intermediate solution.

Changes in earnings may or may not cause alterations in the standard of living, and accordingly the marginal utility of the fluctuating earnings may or may not vary. When it does, a progressive collection like P.A.Y.E. is justified; when it remains the same, P.A.Y.E. is wrong: a proportional tax collection should be used.

A case of the latter type can be constructed in which the annual income is fixed and known in advance, but is received in irregular payments; thereby the annual tax liability is also determined. This case, although truly fictitious, is approached in practice whenever the mean values of fluctuating earnings remain stable. For this case the present progressive collection produces a re-distribution of the earnings of each tax payer. As the collection falls heavy on top earnings, it restrains the tax payer from extravagant expenditure, if he or she is a spendthrift, but to the same extent it prevents him from saving if he is thrifty. It discriminates against cash purchases in favour of hire-purchase agreements. The choice of a progressive collection reflects a pessimistic outlook which assumes that the average tax payer is not competent and thrifty enough to manage his own affairs and needs the Exchequer's adjustment of his wages. Under the assumed conditions where the marginal utility of earnings does not vary the proportional collection is theoretically correct and safeguards the tax payer's interest. Such changes of earnings as do affect the standard of living, however, should be taxed progressively (paras. 40-42).

Revision of E.T.R.

40. It is not claimed that this proposal provides an ideal solution. The difficulty lies in the taxation of current earnings for which the E.T.R. depends on future, unknown events. The revision of the E.T.R. should coincide with the change in the standard of living, but in practice different cases arise with contrary aims. The best solution will be a fair compromise between divergent tendencies. The quarterly use of moving annual totals is suggested as such compromise.

As soon as it is agreed that the progressive tax collection of P.A.Y.E. is unsatisfactory and incorrect, it would be illogical to criticise the proposed reform solely on the ground that some employees would pay more tax under certain conditions. Since the total yield of Income Tax will be maintained, the tax reductions in those cases where P.A.Y.E. is oppressive must be recovered somehow. Three ways are suggested:

(a) increasing the deductions on occasional short earnings (absences, short weeks, etc.);

(b) eliminating tax refunds for periods without earnings, followed in most cases by a reduction in total tax liability, (paras. 17-18).

(c) increasing the deductions, relative to P.A.Y.E., from diminishing earnings. This last feature, which has been criticised, needs careful examination.

Change in the standard of living

41. The question arises: When does a change in earnings cause a change in the standard of living? Obviously, if the person knows that the change will be permanent, the adjustment will be abrupt; in the other event, the effect will be delayed. But this distinction cannot be utilised for tax computations.

In neither case, however, is the effect immediate and complete. The standard of living does not vary from week to week, but is determined to a great extent by the periodical expenditure for durable goods, as housing, furniture, household articles, clothing, cars, and by seasonal expenditure, like fuel, travel and holidays. A man who has earned £20 in a single week can spend his money as foolishly as another man worth £1,000 p.a. but if he tries to spend it wisely, he will find he cannot get everything from one week's wages to obtain, not even for 7 days, the full benefit of the standard of living of the other man. The standard of living does not alter with fluctuating earnings. The extra earnings are usually expended on seasonal or durable goods, leaving thereby a larger slice of the usual earnings for the current necessities. The result is a stable standard of living at a moderately improved level. This still holds good for seasonal variations.

In case of a permanent increase in earnings, the rise in the standard of living follows, but some time passes until an equilibrium is reached. Vice versa: if earnings are permanently reduced, the decline in the standard of living is gradual. Although such person will probably feel his status painfully, economically he is better off than the other person who has been living on the same income for some time.

The time lag between income and standard of living found its expression in the Income Tax Acts prior to 1918, when the tax was assessed on the average income of the last three years. The present dispute concerns the question whether a time lag of 3 months is too long.

Seven cases of changes in earnings

42. Are the tax deductions of the proposed method appropriate to the changes in the standard of living and accordingly equitable and fair to the employee? How do the necessary alterations of the E.T.R. coincide with changes in the standard of living? The following practical cases occur:

(a) *Unsignificant fluctuations of earnings in continuous employment:* no change in the standard of living takes place. Any revision of the E.T.R. should not be too frequent in order to obtain a more stable sample mean ($d = \frac{d}{\sqrt{n}}$). Eight weeks would be the minimum, 13, 26 or 52 weeks are more suitable.

(b) *Seasonal variations in continuous employment, e.g., overtime or bonus payments.* At present the higher payments attract tax as if they would constitute all the year, and the lower payments as if the higher earnings would not exist. In accordance with the comments in para. 41, the proportional tax collection is justified. In order to cover seasonal variations the use of annual totals is essential.

(A similar case, in which the temporary increase occurs for the first time, was illustrated in graph No. 4.* The rise in tax deduction during the low season is small, the annual tax slightly less than under P.A.Y.E.)

(c) *Seasonal unemployment:* The comments of para. 41 re the standard of living apply also to this case. It is illogical to tax seasonal earnings as if they would be permanent. Under P.A.Y.E. the unduly high taxation is followed either by a tax refund during the period of unemployment or by a tax free period at the beginning of the next season, dependent on the calendar date of

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[Continued]

the season. The proposed scheme would considerably reduce the tax deductions from seasonal workers, without diminishing the total yield of Income Tax, by spreading the tax over the whole period of employment and by eliminating the tax refund. Please refer to graph No. 5.*

(d) *Intermittent employment.* No doubt the standard of living is reduced, but it is not fully restored when employment is resumed since arrears and deficiencies have to be made good. The reduction of tax as shown in graph No. 6* is therefore justified. Please see also paras. 18 and 21.

Tax Refunds during unemployment: Tax refunds during unemployment, or sickness, are not an integral part of our system of social security, but are the admitted failure to collect the right amount of tax. They benefit mostly those who need it least, i.e., single persons with medium and higher incomes, and at the wrong times when they are not in special need, i.e., at the beginning of the unemployment. The expenditure saved on the refunds would be applied in a general reduction of tax deductions from persons in seasonal or intermittent employment. If it was considered that the present rates of unemployment and sickness benefit do not account for the rise in the cost of living, then the rates should be increased; the tax refund is an incompetent substitute.

(e) *Permanent increase in earnings:* It is assumed that the rise represents an increase in real wages; inflationary increases are discussed in paras. 16 and 45. The standard of living rises but not as suddenly as the income. The gradual increase in tax can therefore even theoretically be justified. But the progressive taxation should follow after a few weeks. A period of 13 weeks would be acceptable. In view of the necessity to cover seasonal variations (cases (b) and (c)), however, the use of moving annual totals, quarterly applied, is recommended as the most suitable practical compromise. Please refer to graph No. 5.*

(f) *Reduced earnings in continuous employment:* An example of this type has recently been stated by the Treasury, who referred to the case of a married man whose earnings are reduced "without fault of his own" from, say, £5 to £2 per week. The marginal tax deductions for these earnings are 17s. 10d. and 1s. 0d. Under the proposed scheme this man would have the following deductions:

	s.	d.
for the first 3 months (or less) ...	9	7
for the second ditto ...	7	11
for the third ditto ...	5	10
for the fourth ditto ...	3	4
afterwards ...	10	

These rates, however, occur only if all 3 of the following conditions are given: (i) that he was in permanent employment for 12 months; (ii) that he earned an average of £9 per week over that period; (iii) that the reduction of wages takes place without interruption of employment.

The example is extreme because it was chosen on a very steep portion of the Income Tax curve, at the first peak of the differences between M.T.R. and E.T.R. Such a case can occur on partial retirement or on downgrading of employment owing to falling health. But the decline in the standard of living is not so sudden and complete as it first may appear. This man can avoid expenditure on the larger household items, like clothing, for some time without falling below the standard of a married man earning £5. The hardship is therefore less than it appears at first. In occupational cases, due to retirement or ill-health, special tax relief could be given. Economically these cases are unimportant. The question of a temporary inequity should not be exaggerated; more serious, wide spread and permanent hardship is often caused by increases in costly taxes or limitation of subsidies.

(g) *Reduced earnings after a period of unemployment:* This case will occur more frequently than case (f). The tax deduction under the proposed scheme is the resultant of the conflicting tendencies of cases (d) and (f); the deductions may be higher or lower than under P.A.Y.E., or equal to it, according to the duration of unemployment and the measure of fall in earnings. In this case any

inequity shown in case (f) is clearly mitigated. If in the example cited under case (f) a period without earnings of 3 months would exist, the following deductions would be made from the earnings of £5 per week under the proposed scheme.

	s.	d.
First 3 months ...	5	5
Second 3 months ...	2	6
Third 3 months ...	5	
Fourth 3 months ...	Nil	
Afterwards ...	10	

Summarising this paragraph, it may be stated that the proposed scheme would affect the employees as follows:

(i) The objectionable peaks of deductions from top earnings will not occur; short weeks will bear relatively higher deductions than now.

(ii) Seasonal workers will have much lower deductions in the season; if employment is continuous, a negligible increase during the off-season will occur. If there is some seasonal unemployment all deductions will be less than today, but the total liability will remain unchanged.

(iii) Unemployed persons will not receive tax refunds; they will have smaller deductions on resuming employment and pay less total tax in the first year of their new employment.

(iv) The tax on rising earnings will in the first year be less than today.

(v) Employees with falling earnings will pay more in the first year than under P.A.Y.E., unless the fall in earnings is preceded by unemployment.

The extent of the differences is shown in the Tables 2 and 3 of para. 23.

These differences should not be considered as residue between an incorrect tax collection and the true tax liability, but as difference between two methods of taxation: P.A.Y.E., which taxes earnings on a week to week basis and arrives at a tax liability for the fiscal year, and the proposed tax, which varies the tax liability in proportion to the current income, but bases the tax rate on the moving totals of the last 12 months. The tax liability is thereby freed from the operation of the annual accounting date of the fiscal year. In para. 18 an example was given of a single man earning £7 15s. 0d. whose tax liability under P.A.Y.E. varies by as much as £36 10s. 0d. solely because of the different calendar dates of the period of unemployment. For prolonged unemployment that case has practical importance.

Monthly Salaries

43. The preceding paragraphs referred mainly to weekly wages. For fixed salaries incomes the proposed reform would be indifferent in every respect. But many salaried persons receive irregular payments, often in connection with achieved results as bonuses, profit sharing, etc. To dispense the impact of taxation for these payments over the moving annual totals would have a beneficial effect on incentives in a group of persons whose activities are highly important and whose taxation is heavy.

As to the effect on revenue it will be noticed that the value of "D" (para. 15) does not directly depend on the amount of earnings, but on the ratio of q/A . The higher salaries would therefore not generally cause a higher value of D. Such value, however, would occur for persons in higher income groups with a greater number of dependants; for these both "C" and "D" would be large. There should be no objection to extending the advantages of the proposed scheme to this relatively small group.

It is therefore suggested to apply the scheme to weekly and monthly wages and salary payments irrespective of the amount. Persons who receive a small portion of their incomes from other sources will have their code number adjusted as at present. Where however separate assessments under other Schedules are made, the proportional deductions should be treated as provisional payments. They could be based on an E.T.R. fixed annually by the Inspector of Taxes; any excess payment would be refunded.

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[Continued]

Collection of revenue

44. From a fiscal point of view P.A.Y.E. is satisfactory. It collects the total tax liability at the proper date, and even earlier, with little expense to the Government. The administrative success of any tax is very important. Before any alteration of P.A.Y.E. could be recommended, assurance must be given that the economic advantages of the reform do not jeopardise the fiscal success of the old method. This point should, however, not be carried to extremes. The method of tax collection preceding P.A.Y.E. carried arrears of 10-11 months tax. The question of collection of revenue and yield has been fully discussed in paras. 11 to 21.

Proportional tax under inflationary conditions

45. The claim made in para. 20 that the proposed method would provide at least the same revenue as P.A.Y.E. holds only for stable monetary conditions. During a period of inflationary increases of salaries and wages, the proposed tax would in the first year of any rise give a smaller increase in revenue than P.A.Y.E. does. To the same extent, however, it would ease, or at least postpone, the demand for further wage increases.

Administrative details

46. (a) *Casual Employment*: If a new employee has been in some other employment during the same quarter, no recalculation of the tax rate is required; the same E.T.R. is used. If he then leaves again in the same quarter, the entries of the old P.45 can be transferred to the new one, only the earnings in the current quarter are brought up to date.

(b) *Table of quarterly earnings*: A sample of a table of quarterly earnings, which would form part of the employee's tax card, is shown below; it is self-explanatory:—

Period	Earnings in £s.				
	Ten. fin. prev. Qd.				
2nd Quarter, 1950	90	XXX	XXX	XXX	XXX
3rd Quarter, 1950	95	95	XXX	XXX	XXX
4th Quarter, 1950	103	103	103	XXX	XXX
1st Quarter, 1951	135	135	135	135	XXX
2nd Quarter, 1951	XXX	85	85	85	85
3rd Quarter, 1951	XXX	XXX	120	120	120
4th Quarter, 1951	XXX	XXX	XXX	142	142
1st Quarter, 1952	XXX	XXX	XXX	XXX	115
Mov. Ann. Tot. (MAT)	423	419	444	483	453
E.T.R. (p. 6)	2-9	2-4	2-10	3-1	2-11
Valid for Quarter	2nd	3rd	4th	1st 1952	2nd 1952

The E.T.R. is found from a special table (para. 9).

(c) *Change in family status*: Any alteration of the Code number could take immediate effect; it could be applied from the start of the current quarter, any refund to be given at the end of the quarter. The present practice rather discriminates against persons whose status changes in the fiscal year. There is also no practical difficulty to applying the higher Code number to one or two preceding quarters, if this were recommended.

Definition

47. If the annual reconciliation is not used (para. 16 and 19), the tax liability under the proposed scheme could be defined as follows:—

EXAMINATION OF WITNESS

2214. *Chairman*: Mr. Hughes, thank you for your careful and detailed paper, which has been a great help to the Commission. I have one or two questions, not many, because I think I followed your argument. Let me see if I have followed you right. I think your theme is that throughout the paper with regard to P.A.Y.E. is this, in general not, I just took one or two quotations from it, "In general the quicker the marginal tax rate follows the extra effort, the stronger the repressive effect. This point contains my

"The tax due from earnings received during three months after the date of 5th April, 5th July, 5th October, or 5th January, is the tax due, in accordance with the provisions of Schedule E, on the earnings received during the twelve months preceding the above date, multiplied by the ratio of the earnings during the three months after the above date to the earnings during the said preceding twelve months."

Popular explanation

48. A popular explanation may read as follows:—

"Your Income Tax is deducted from your wages at a certain rate per £ of your earnings. Your weekly deduction is this rate multiplied by your wages to the nearest 10s. You pay therefore the same rate on your extra earnings as on your basic pay."

"This rate depends on your Code number and on your income. The rate is revised every three months and is, in fact, the tax on your income during the previous twelve months, divided by that income."

"You will be notified of your tax rate every three months, so you can check your deductions."

Table of Tax Rates

Income during last 12 months	Or in the average per week	Tax per £ of earnings		
		Single	Married Man	Married Man 1 Child
£	£	s. d.	s. d.	s. d.
216	4	11	—	—
260	5	17	2	—
312	6	2 1	8	—
364	7	3 5	1 2	5
416	8	4 8	1 7	8
468	9	5 11	1 11	1 1
520	10	6 5	2 2	1 5
572	11	7 10	2 6	1 8
624	12	8 1	2 11	1 11

"Over a whole year you will pay the same tax as under P.A.Y.E. if your income in the year is the same as before; if your income is higher, your tax will rise in the first year to a lesser degree than under P.A.Y.E., in the following year you will pay the same tax as under P.A.Y.E."

"The new method leaves you your full share on all extra earnings and abolishes the tax favours to shuntmen. There will be no tax refund for weeks without earnings nor during unemployment. But owing to the loss of income your tax rate in the following quarters will be reduced. Seasonal workers will have smaller deductions, but no tax free periods or refunds; they will pay the same tax over a whole year as under P.A.Y.E. The tax after a period of unemployment will be less than under P.A.Y.E. On a reduced income in continuous employment your tax would first be reduced in the same proportion and would in the first year be higher than under P.A.Y.E."

"The new method restores the normal connection between effort and reward, undisturbed by irregular tax deductions. Each pound earned or lost, is worth to you after taxation 17s. to 19s. cash, not only 15s. 7d. or even 12s. 5d. as under P.A.Y.E. It is therefore worth your while to earn that extra pound: the country needs your work—you need the country's money."

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essential criticism of P.A.Y.E." Would that be right?—That is right.

2217. It is in paragraph 26. And the new form of P.A.Y.E. that you advocate in your paper is directed primarily to removing what you believe to be the repressive effect?—Yes, that is so.

2218. I quite follow that a scheme on the lines which you advocate could indeed be adopted, but what I want to get, for the help of the Commission, is how far we are

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[Continued]

to believe that the present system has a repressive effect. I would just like to get your own experience, because it would help me to judge of the importance. You are, I think, in business in York, are you?—Yes.

2219. What is your activity there?—I am at present in a very small clerical employment. I have given my personal experience in paragraph 36 of my paper. I could not add anything to it at present.

2220. Does your profession bring you into personal touch with people who are having their tax deducted under the present P.A.Y.E. system?—Yes, I have been in touch, may I quote from this document: "The married woman in charge of a workroom who preferred to work shorter hours after she had observed the variation of her tax deductions on an occasional overtime, thus leaving her workroom without supervision."

2221. Is that a case with which you yourself came into touch?—Yes, it was a case in 1947.

2222. Is it your experience that people sometimes use the tax reason for not doing something they do not want to do for other reasons as well?—Motives of persons are of course difficult to examine. I was careful not to exaggerate the effect of P.A.Y.E., and my estimate, which I have given in paragraph 38, is in the region of £60 or £70 million as the possible increase of national output if the disincentive effect of P.A.Y.E. is removed.

2223. Yes, I follow the assumption, but I want to get your own personal experience, because if we can we want to find out what there is in this repressive effect.—My personal experience is so small, Sir, that I hardly have any observations to report to you on this. The occasions were, first, the woman in charge of the workroom who found out it is not worth while to work till 6 o'clock because she only gets a few shillings more for it, but pays much more tax, so she left at 4 o'clock. There were about ten employees who were left in the workroom without supervision. The other case was of the craftsmen who worked in a light aircraft factory, and who asked whether a bonus could be paid weekly because they thought the P.A.Y.E. deduction would be smaller. I explained to them that that was not the case, it would be exactly the same, but it shows the influence that P.A.Y.E. still had on the men, the case was in 1949.

2224. It does not show very much, does it, that second case, except that they had in mind which form of payment might help them more with regard to their tax deduction. That is quite natural, is it not?—Yes.

2225. Then you tell us of a circular.—Then there was the other case of the foreign workers in civil engineering work, they refused to work on a Saturday and said it was definitely because of P.A.Y.E.

2226. Yes, I am glad you reminded me, I wanted to ask you about that. Were they foreign workers who had for the first time come into touch with the P.A.Y.E. system?—Yes.

2227. That was their first reaction to it?—Yes.

2228. I suppose it is true to some extent, is it not, that people's reaction to a tax when they first come into touch with it is not necessarily the same as their reaction after they have become more habituated to it?—No, acute symptoms may become chronic, and there may still remain some influence, but at least acute symptoms show that P.A.Y.E. tends to restrain the men from giving their very best. I do not want to make the claim too large, but I think two or three per cent. of the national output may be the difference. I have tried to put the case on a more theoretical basis in a paper which I submitted two or three months ago,* but it was rather complicated.

2229. It contained for me, who am not a mathematician, a detailed mathematical analysis. Then you give us in the paragraph to which you are referring, details of a questionnaire which was sent round by the Leeds branch of the Institute of Cost and Works Accountants; they put the question to their members: "In your experience does the incidence of P.A.Y.E. militate against incentive schemes?" and you go on to say: "The sample comprised highly organized medium and large establishments averaging 800 employees, most of whom were paid by results. There was little definite evidence

that output is restricted owing to P.A.Y.E., but approximately one-third," that is one-third of the member firms, I take it?—One-third of the members who replied.

2230. Yes, "considered that it may have some repressive effect." Not very strong, that is it?—No, Sir, but the interesting feature was that all the replies came from very large units, which were very well organized, had very balanced incentive schemes based on time and motion study, and proper supervision, and my opinion is that in these cases the incentive schemes have been upgraded so as to compensate for the effect of P.A.Y.E. P.A.Y.E. reduces the variability of wages in terms of effect by 12 to 15 per cent., that is the difference between marginal and effective tax rates. If the incentive scheme is upgraded by 15 per cent., the effect of P.A.Y.E. is counteracted, but this has to be paid for by the incentive scheme. That does not lead to higher earnings, but it leads to a bonus scheme that is steeper, and it is in some industries not very practical.

2231. So in your view we ought to think of everyone whose reward is affected by the amount of work that he does as being in some extent repressed by the present system?—Yes.

2232. The people who are able to work overtime, the people who might have been affected by incentive or bonus schemes, they are the kind of people you are thinking of?—Yes, it makes it easier for a man to take two days off, because he is left with a larger wage packet of net wages than if the reduction were on a proportional basis. P.A.Y.E. hides from the man the proper relationship between his earnings and his efforts, it distorts it. He does not seem to get his full reward from any extra effort, and he does not seem to suffer his full reduction in wages when his effort slackens or is reduced.

2233. Your proposal is this, is it not, that you want each employee's tax to be a fixed proportion of what is paid him for a quarter?—Yes. May I say this, the ideal solution would be to base the rate on the current earnings of the year, but this cannot be done because we do not know at the beginning of the year what the man will earn. The next best solution is to assume that the earnings which he had in the last year would continue at the same rate and to check at suitable intervals whether that assumption is correct.

2234. And you accompany that by reviewing at the end of each quarter what the total earnings for the twelve months preceding the end of that quarter have been?—Yes, Sir.

2235. And applying the tax rate for the current year and the tax allowances to see what rate you should apply for the quarter that is then to follow?—That is so.

2236. You are still keeping, by that system, are you not, within a progressive tax scheme; in other words, the more effort he has put into his work, and the more reward he earns in that preceding twelve months, the higher rate you will be applying to the quarter that follows?—Yes, but that progressive effect would be much reduced; firstly, any fluctuations would cancel out; if he has earned more in one week and less in the other that would not affect the total. Secondly, the removal of the tax refunds would make the average tax rate lower than the present average tax rate, because the present average tax rate must provide for the tax refunds which are given. The result would be that the employee would notice the tax deduction much less than he does now. The peak deductions to which the man object would disappear. The average of the deductions would be a few pence per £ less than it is now.

2237. The success of your scheme would consist in correctly ascertaining the wages for the previous twelve months, would it not?—Yes.

2238. Yes, I think, envisage the employer as being the person responsible for that?—Yes, and I think it can be done without any difficulty. I think I can answer all the points which have been raised in the memorandum of the Board of Inland Revenue.*

2239. For a man who is in constant employment with the same firm I would not have thought there would be much difficulty, but must one not think of many employees

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who hold a series of jobs during the course of the preceding twelve months? How does the employer make himself responsible for them?—I have referred to that in paragraph 10 of my paper: "On change of employment the following information would be required on form P.45", form P.45 is the certificate to which the Board of Inland Revenue refer in their paragraph 11.

2240. This is a form which the employer is going to fill up, is it?—The employer hands that to the employee leaving the firm, and the employee brings it to his new employer.

2241. What was puzzling me was the person who changed his job several times in the period that P.45 would be dealing with, would it not be rather difficult for the employer?—No, Sir, he had to show on that form the wages of the three preceding quarters. I would like now to make an amendment on this point. I would say instead of three preceding quarters, four quarters, and an employee changing from one job to another will always bring that form to the employer, and that form contains all the information which will enable the new employer to assess the tax and to make the deductions.

2242. You mean it would be in effect cumulative from employer to employer?—Yes, the history of the wages in the last year would pass from one employer to another. I have also referred to that later on in paragraph 46 (a), to show that where such changes of employment are very frequent there is little extra work involved to the employer, because most of the entries on the certificate have only to be copied from the previous one which the employer received from the preceding employer.

2243. You have somehow to cope with the question of the man who has not had employment in the previous twelve months, have you not?—Yes.

2244. I think under your system you impute to him some basis of remuneration?—As the tax is calculated as a product of current wages times the effective tax rate, and as the latter is based on the earnings of the last year, that product becomes zero if one of these items becomes zero. To compensate for this some adjustment is necessary. I have suggested that if a man were unemployed for more than six months, the balance in the current quarter should be used as notional earnings and should be placed in the totals once again. I had in mind, and I think I have stated it, that that procedure should be applied at the end of the first quarter. The man would be tax free or practically tax free in the first three months and he is actually tax free in many cases today.

2245. I only wanted to get at what you were saying. I said, you impute to him earnings when he has not had them in the past, that is right, is it not?—Yes.

2246. And as you say, if we are going to base the tax on what in fact he is getting in the current year, you must wait three months to find out what the rate of earnings is?—May I show in this connection what happens today. If a man enters employment on the 6th April he is taxed immediately. If he enters employment on the 6th October, he is not taxed until the portion of the personal allowances is covered by wages. If he earns, say, £200 in six months and starts work on 6th April, may I use the rates of 1951-52, then he receives income at the rate of £400 p.a. on which he has to pay £51 10s. tax, therefore for six months he has to pay £25 15s. If he enters on 6th October and earns £200 to the end of the year the tax is calculated as if his earnings were not £400 but only £200 a year, and he pays only £7 10s. tax. In this case a tax free period of approximately three or four months occurs even today. The effect of placing notional earnings in a preceding quarter would be that in the average the tax from such a person who had been unemployed for approximately one year would be 10 per cent. less than is now in the average under P.A.Y.E. I have shown that under P.A.Y.E. for that person the tax liability varies up to £36 10s. for a single man with £400 only according to calendar date of the period of unemployment. I thought that a reduction of the tax liability in this case of 10 per cent. could be granted. If, however, this was considered too much, some alteration could be made in the following way. The notional earnings could be entered twice, they could be entered in the first preceding quarter and, I suggest, in the third preceding quarter, and that would give in the average for that person the same yield of

tax as it is at present. As to the case of first employments, I did not make a special comment on this because most of these first employments will be tax free, such as apprentices, junior labour, who earn only a few pounds and do not pay any tax on that. Higher earnings will of course occur for professional men who enter their first employment, and for foreign workers. If it is desired to keep here the average tax exactly the same as it is now under P.A.Y.E., this can again be done by, this is my recommendation which I submit to you now, Sir, by entering the notional earnings in all three preceding quarters. Such a person would remain tax free for the first three months and after that he would pay a fairly normal effective tax rate. May I give an example: if he has £400 a year again, the full effective tax rate on the rates of 1951-52 would be 2s. 7d. per pound; if notional earnings of £100 are placed in the three preceding quarters that gives then an effective tax rate of 2s. 7d. after the first quarter. He would be tax free for three months and afterwards he would pay 2s. 7d. If, say, notional earnings are placed in the two preceding quarters his effective tax rate would be, after three months, 2s. for three quarters and after three quarters, 2s. 7d. In that way the scheme is very elastic and can be adjusted to any desired degree of precision.

2247. There are two things I wanted to draw your attention to, in addition. I think you have faced the fact that under your scheme, if you base the rate on the previous 12 months' earnings, you will have some difficulty with the man whose wages are falling in the current year.—Yes, Sir, I have dealt with that point in my paper to some extent, and I would like to say this: I consider that the alteration in the weekly deduction is the minimum required to exclude the disincentive effect. My scheme depends on the question of the disincentive effect. If the disincentive effect of P.A.Y.E. is negligible, then there is no need to modify it. The hardship caused by the relatively higher deductions from falling earnings, and by the omission of the tax refund during periods of all earnings must be set against the loss of notional output due to P.A.Y.E., which is a sacrifice borne by the whole community. My scheme causes less aggregate hardship in removing this disincentive effect than any other more orthodox method. The scheme obtains its results without shifting the incidence of the tax burden from one income group to another.

2248. I follow that. I think what you are saying is that you recognise that there will be hardship involved in some cases when you apply the rate appropriate to basic earnings to wages that may be falling. Against that you set the advantage of getting rid of the disincentive effect that you attribute to the present system, or a large part of the present system?—Yes.

2249. But what would you do if you had a really serious case of hardship owing to applying to current wages a rate drawn from earnings which were no longer true of the man?—I have referred to such a case in one point in my paper, and in view of the comment of the Board of Inland Revenue I would like to make a further comment: I think in a case of a retirement or a disablement a different treatment is justified, because in this case the reduction in earnings is permanent. If the reduction in earnings is due to short working or any loss of orders or deficiency of material, then this short work will be compensated later on by higher earnings. If you follow the Table III, Sir, in my scheme, on any fluctuating earnings the total deduction is never more but always a little less. Then, over a whole cycle of earnings, from normal earnings to higher earnings, or even to lower earnings, and back to normal, over such a whole cycle any person, in total, will always pay slightly less tax than under P.A.Y.E.

2250. Have you considered whether considerations as to how it will even out over a whole cycle are really applicable to people who live largely by a weekly budget?—It would not change the tax which is taken from them in total. It would be more inconvenient to them to pay a slightly higher tax on falling earnings, and I only suggest it to remove the disincentive effect, but I say that this solution involves less hardship than any other method. I would in that connection refer to the difference in the income tax rate between 1951-52 and 1952-53: the changes of the rates in the Finance Bill, 1952, reduce the yield of income tax by £144 million for a full year, according to the Financial Statement, only considering those changes

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which affect the marginal tax rates, and thereby a disincentive effect, that is the change in the earned income allowance and a change in the range of reduced tax rates. This loss of revenue has to be compensated by a reduction in expenditure. On these changes, I can only come to the conclusion that the disincentive effect must have been considered extremely high. The fact is, however, that these changes in the Finance Bill reduce the disincentive effect only by approximately one-quarter; three-quarters of the disincentive effect still remain. Under the new rate, for single persons who earn between £3 13s. and £8 16s. per week there is no improvement in the disincentive effect between 1951-52 and 1952-53. If we have this in mind, I think that my scheme achieves the effect with very moderate sacrifices. My scheme would enable a progressive high yielding direct taxation to work without harmful effect on output, at least as far as lower income groups are concerned.

2251. We shall, of course, take your scheme into careful consideration. I was only trying to get quite clear what your points are with regard to some aspects of it. One last point: do you advocate a final assessment at the end of the year to see how the tax that you have deducted by your system bears to the true tax for the year? You envisage both possibilities, I think?—Yes, it can be done in both ways and it is practicable as far as the administration goes, both ways. To see that annual adjustment would not involve particularly heavy work. I had in mind that the annual adjustment should be performed by the employer, not by the tax officers. This is my answer to the comment of the Board of Inland Revenue on that point.

2252. Does that mean you would really put the responsibility for what would be assessment upon the employer?—What I have in mind is that employers keep on the tax card an ordinary debit and credit account. They enter on the debit the total tax due for the year, on the credit side the total tax deducted, and carry the balance down.

2253. Does the employer then become the effective assessing authority?—He is so at present, Sir. Under Section 30 of the Finance Act, 1948 (now I.F.A., 1952, s. 138), no assessments are made if the deductions are in order. He works it by tables, and he would work it under instructions which are free from any ambiguity or arbitrariness in future.

2254. Yes, but there are two separate things, are there not? If, of course, the tax authorities gave him complete instructions which covered all cases he would merely be acting as their agent in doing what he did with regard to the man's tax, but I thought you were envisaging that the employer would have a responsibility which would turn him really into the taxing authority?—The real assessment is actually done by the code, by fixing the code number. In that way the size of the personal allowances and all personal conditions are defined, and this is, of course, still left under my scheme with the inspector of taxes. What would happen is that the tax is calculated at the end of each quarter, that the tax is recorded on the tax card as deducted, and at the end of the tax year the total tax due is found. I will show a way in which that can be done very simply. The effective tax rate for the first quarter of the new year times the total wages in the last year, give the total tax due. There is a slight inaccuracy in this because the effective tax rate is adjusted to the nearest penny, the error is only a few shillings and it has no bias. If you prefer you can use the tax tables A and B, the existing tables for week No. 52, and you find the exact amount which was due for the year. Against this the employer puts the amount of the tax which he has deducted and brings the balance down. There is one important point, the moving annual totals affect the tax rate, and the deductions for the full 12 months. A balance of under-recovered tax or overpaid tax at the end of the first year is quite irrelevant, because the moving annual total will mop up any under-payment or repay any overpayment during the year. Only if at the end of the second fiscal year the balance is still left in the employer's account on the tax card, then it is obvious that this would not any more be affected by moving annual totals. My suggestion therefore is this, and in that I slightly modify what I have first given in paragraph 19. If the balance appears in the first year, the employer will not take any action. If the balance in the second year appears on the other side of the account, if, for example, a debit balance changes to a credit balance, no action is required. If the

balance remains on the same side of the account as a debit or a credit, then either the old or the new balance, whichever is less, as if it is a credit balance repaid, if it is a debit balance divided by the income, and that is added as an addition to the effective tax rate of the year. I describe this in detail to show that it does not involve any administrative difficulty. It can be done. The only drawback is that it takes about two or three years to come into full operation, and I have another point in mind, Sir, which actually made me not recommend this annual adjustment. This method would perpetuate inequities which exist in the present system, i.e., the annual allotment of personal allowances irrespective of the calendar date. At this point I want particularly to refer to the memorandum of the Board of Inland Revenue. If a child is born on 6th April the annual allowance for the child appears in the new year; if a child is born in March the annual allowance is given for the past year. The same applies for marriages and for deaths of dependent relatives. In that way the tax liability varies by £30 to £30 only due to the calendar date of the critical event. The second case is of men who have been in intermittent employment and have been unemployed for a long period. In these cases too the tax liability can vary up to £36, depending whether the period of unemployment falls into one fiscal year or whether it spreads over two fiscal years. There is injustice between different cases, which I mentioned in my paper, but not in great detail. If you think, in view of the calculation of the assessment on the annual basis, you would like to retain it, then you should use the annual adjustment; but if it seems fairer to adjust these personal allowances in accordance with the passage of time, then the annual adjustment could not be used.

2255. I am much obliged, I just wanted to get clear what I think was coming out of your answer to me. You envisage that the employer should carry out at the end of the year a reconciliation under which he would ascertain what tax he has taken during the year, and see what relation that bore to the true computation of tax for the year?—Yes.

2256. But you think that he should then, if he had taken too much, carry it forward until the end of the next year?—Yes.

2257. And not repay it at once?—No, because overpayment would occur when the wages fall. But the moving annual totals work into the next fiscal year.

2258. Yes, I quite follow that. On the other hand, if he had taken too little tax, as shown by the reconciliation at the end of the year, he would carry that liability forward again into the next year and recover it, if he could, from the wages in the next year?—Yes.

2259. Chairman: Thank you.

2260. Mr. Milford Tucker: Mr. Hughes, my questions will be quite short and I would for my own benefit like definite answers to these questions: do you say of your scheme that it produces a more accurate result every year for the employee than the present scheme?—Not every year, Sir, if that is the operative word in your question.

2261. I will put my question again, and in a slightly different form: under the present P.A.Y.E. system, there is very rarely any final assessment upon the particular employee, that is right is it not?—Yes.

2262. Does your system give a more accurate result than that?—No, Sir, the result of P.A.Y.E. is perfectly accurate. If the purpose of the tax scheme is to collect the correct tax at the end of the fiscal year, I can make no improvement on P.A.Y.E.

2263. In so far as you leave it to the employer to do the final adjustment at the end of the year, how long do you think it will take him in practice to do it, with a fairly large staff of work people?—Very little time, Sir.

2264. He has to get particulars from each one of them, has he not, as to what have been the alterations in their circumstances during the year?—No, Sir, the alteration of circumstances is covered by the code number. If there is an alteration in the circumstances of any taxpayer the inspector of taxes will give a new code number.

2265. That will come in your ordinary quarterly adjustment, will it?—Yes. The annual adjustment is only necessary because the moving annual total transgresses the end of the fiscal year.

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[Continued]

2266. That answers my first question. The second question is: you are a professional and practising accountant, are you not?—I am a registered student of the Institute of Costs and Works Accountants.

2267. I thought you had actual professional experience, either in this country or in other countries?—I have worked as accounts clerk and cost clerk, and as an industrial accountant in this country.

2268. That would give you very close-up personal experience, would it not?—Yes.

2269. Would you say that the cost of your scheme, of operating your scheme, is the same as, more than or less than the present cost, both to the Inland Revenue and the employer, of the present scheme?—I would say it is less for the employer and about the same to the Inland Revenue. I have considered that point, and I would like to make it clear in this way: at present each week the same work has to be done by the employer, that is, 52 times the work. I call that present weekly work of an employer for one taxpayer one unit. This one unit consists actually of seven operations. The wages clerk must select the proper tax card, must transfer the actual weekly wages from his wages record to the tax card, Operation 1. Operation 2: he must add that weekly wage to the aggregate cumulative total of the previous week, Operation 3: he must look up Tax Table A. If special stationery is used, this operation is omitted, but this involves the cost of the stationery; Operation 4: he must deduct the amount found in Tax Table A from the aggregate total, Operation 5: he must look up Tax Table B, find the total tax due to date. Operation 6: he must deduct from this tax the total tax of the previous week. Operation 7: he must transfer the final weekly tax to the wages record. Under the present system this will take only a few seconds. Under my scheme the first and last operation would be the same, and in addition there would be one more operation, multiplying the effective tax rate by the weekly wage corrected to the nearest ten shillings, which can be done by a ready reckoner, therefore instead of seven operations you have only three each week, and my estimate is that the weekly work could be done in half the time that it is at present, therefore instead of 52 units you would have only 26. In addition to this there is the quarterly adjustment. If you wish I will go into details, but I find there are about ten operations in the quarterly adjustment, and I assume that the time necessary for it would be two units which makes eight units for four quarters. A further advantage is that the quarterly adjustment can be done in the slack period in the wages office after pay day, whilst the weekly work must be done between the end of the current week and the pay day.

2270. I do not want to stop you, Mr. Hughes, but although your account of what the seven operations were under the present system, sounded rather an alarming list, in fact it is a very short thing altogether for an experienced clerk, is it not?—Yes.

2271. Could you give us a general idea now of the staff required, without going into a tremendous amount of detail. Take a business, say, with 1,000 work people, have you ever met such a business, in practice?—No, I was only in a smaller business.

2272. What was the size of the one you were engaged with?—200 persons.

2273. Now we will ask for your personal experience, because you can help us. How many people were engaged on the P.A.Y.E. with those 200 people?—In the wages office between three and four wages clerks were

engaged. My experience was that the men did not always do P.A.Y.E. work alone, they did something else simultaneously. My point is this. I would not recommend a change of P.A.Y.E. in order to save clerical work. My argument is only that my scheme does not involve more work but rather less. That is, 26 units plus 8 is 34, plus the annual adjustment, and I think the annual adjustment is not more work than the quarterly adjustment.

2274. You are giving your evidence very fairly, Mr. Hughes, and I think you have said what I expected you to say in the end, that there is in fact no saving of manpower of any quantity under your scheme as compared with the present scheme?—Not very much. I would not say nothing at all, there may be some later on when the scheme is well established, but it would not justify introducing my scheme in order to obtain a saving in manpower.

2275. The upheaval would not be worth the saving, is that what you mean?—Yes, the main purpose of my scheme is to counteract a disincentive effect.

2276. That is what I was going to ask you, is that really what you are getting at? It is the disincentive effect, which has been explained by other witnesses, either because it encourages periodical absenteeism or because it operates against the taking on of overtime work?—Yes, and it also discourages the use of incentive schemes.

2277. You mean output bonus schemes?—Yes, particularly for small units.

2278. Now, Mr. Hughes, you have explained to us why you say that, and the number of instances you give. Would you tell me this: in all the individual cases you have referred to, would they be people who were employed in a place where there was no pension scheme? For example, the lady who would not stay in the workroom, would you know whether she was engaged in a firm which had a pension scheme for its employees?—No, there was no pension scheme.

2279. Would that apply to all the other people you have referred to, the bricklayers and the foreign workers?—Yes, there was no pension scheme in operation.

2280. If for individual workers of that type there was introduced in the future a provision which enabled them to provide out of tax income, at the expense of the income tax, which they would have to pay, some provision for their old age themselves, do you think that might encourage them to work harder and earn more so as to get a bigger allowance to put aside for the future?—Would you say, Sir, that their pension would depend on the size of their earnings?

2281. No, supposing you get a man who is earning £10 a week in a firm which has no pension scheme at all, so that when he leaves in his old age there is no pension for him, will you assume that position?—Yes.

2282. Supposing the law is altered, and that man is permitted to take a particular percentage of his income and to pay it into a fund or pay it to a life insurance company, to provide him with a pension that that particular contribution will buy, do you think that would encourage people to earn more money so as to get a higher amount that they could set aside for their old age?—I have no experience of this.

2283. If you have no experience, I do not want you just to invent answers for us. I wondered whether you could tell us from your own knowledge?—No.

Chairman: Thank you very much for your help to the Commission, Mr. Hughes.

The witness withdrew.

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Mr. H. S. BOOKER

[Continued]

Mr. H. S. BOOKER, called and examined.

MEMORANDUM SUBMITTED BY MR. H. S. BOOKER

A NOTE ON DIRECT AND INDIRECT TAXATION SINCE 1945

1. This note is intended to supplement those analyses which compare the present position with that of 1938 and seeks to draw attention to a factor in taxation which seems not to be generally realised. A general attitude is that since 1945 tax changes have discriminated against the wealthy and the middle classes in favour of the working classes.* This is only partly true as is indicated by the following table:

Net income of married men without children

Income before Tax per Year	Income after Tax		Increase since 1945
	1945	1951-2	
Earned			
£350 ...	291	331	14
£1,000 ...	649	766	18
£2,000 ...	1,174	1,367	18
£4,000 ...	1,905	2,149	13
£10,000 ...	3,168	3,399	7
Unearned			
£1,000 ...	599	671	12
£2,000 ...	1,099	1,196	9
£4,000 ...	1,630	1,739	7
£10,000 ...	3,063	3,209	4
£20,000 ...	4,530	4,634	decrease 2 per cent.

2. Compared with a typical income of £350 a year the changes in income tax have discriminated against those who earned incomes in excess of about £4,000, and those with unearned incomes of £1,000 or more. Most of us would say that the discrimination is against the wealthy and those members of the middle class whose only income is investment income. On the other hand there has been marked discrimination in favour of the middle class with earned income.

3. The truth about discrimination against high incomes indicated in the above table obscures the more important truth that there are few high incomes. The Commissioners of Inland Revenue in their 92nd Report (Cmd. 8052, p. 87) estimated that there were 204 million incomes over £135 in 1948-49. Of these 93 per cent. were not greater than £1,500 and 87 per cent. not greater than £500. The remainder of this note concentrates upon what has happened since 1945 in the typical income ranges on the principle that a tax system is not judged only on its influence upon 2 per cent. of the people it affects even though that 2 per cent. may be very important. An attempt is made to show that the successive reductions in income tax from the October budget of 1945 to that of 1950, even when modified by the increase of the 1951 budget have discriminated in favour of the higher earned incomes and against families with children in a very marked degree. The following table summarises the position:

Increase in net income, assuming gross income unchanged, resulting from changes in income tax from 1945 to 1951 inclusive. Income all "earned" and by the husband in the case of married couples

Income before Tax	Single Person	Man and wife	Man, wife and 1 child	Man, wife and 2 children	Man, wife and 3 children
(per year)	(increase) Per cent.	(increase) Per cent.	(increase) Per cent.	(increase) Per cent.	(increase) Per cent.
£					
250 ...	14	12	9	0	0
350 ...	18	14	12	7	4
500 ...	22	20	17	15	12
1,000 ...	18	18	19	19	20

* "... the whole secret of the middle classes' attitude to the Government" ... has ... "changed from white fly to hart beset by the workers against the cross." *Leah & Mendel, The English Middle Classes*, p. 95.

4. The table illustrates the position with respect to a very large proportion of incomes. The first three lines, relating to incomes of £250, £350 and £500 a year represent low, typical and high incomes for adult male wage earners and are probably not unrepresentative of a large range of clerical and shop assistants' salaries. The fourth line, relating to earned incomes of £1,000 a year is included for purposes of comparison and is roughly representative of most of the highest 5 per cent. of incomes. It is important partly because it shows substantial benefits from income tax reduction since 1945, but also because it shows in these high incomes no discriminatory effects against families with children, but rather benefits for such families.

5. There has been no intention to discriminate against children and against lower incomes as a result of tax changes; these discriminations have simply been accidental effects of the decision to reduce direct taxation, mainly in order to increase incentives, but partly to remove that part of income tax which was a forced interest free loan. The discriminations are indeed almost inevitable effects of reductions in income tax when typical working men, especially if they have families, pay very little tax. How far is it desirable to increase incentives by reducing income tax when the reductions have this social influence?

6. In considering the question asked in the preceding paragraph it is necessary to remember that the reductions in income tax described were not part of general reductions in taxation. It was found necessary to make compensating increases in indirect taxation in order to limit inflation. This influence can be illustrated by comparing Exchequer receipts in 1944-45 with those in 1950-51 as follows:

Exchequer Receipts

	1944-'5	1950-'1	Increase	
	(£m)	(£m)	(£m)	Per cent.
Inland Revenue ...	2,029	2,636	607	30
Customs and Excise	1,076	1,630	554	51
Continued ...	3,105	3,666	562	18

7. It is appropriate for this purpose to substitute Inland Revenue for Income Tax and Surtax because the amount of the two latter amounts includes Income Tax on undistributed profits which are directly influenced by changes in the rates of Profits and Excess Profits Taxes. The cessation of Excess Profits Tax automatically increases the yield of Income Tax. It will be noted that despite the reductions in rates of Income Tax the total amount raised from Inland Revenue has been substantially unchanged. This is associated with the continuing rise in money incomes.

8. Further, it is necessary to note that the policy of transferring from direct to indirect taxation was significantly reversed in the 1951 Budget, the estimates providing for £264 million extra from Inland Revenue and only £21 million more from Customs and Excise. These estimates are without any material contribution (in the current year) from the increased tax on distributed profits and without any contribution from the suspension of the initial (depreciation) allowances.

9. It is not easy to assess the influence of indirect taxes in terms of the income and family responsibility of the person who pays. Important features of revenue from Customs and Excise are given below:

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[Continued]

Customs and Excise Receipts

	1944-45	1950-51	Increase
Tobacco	£m 383	£m 604	£m 221
Purchase tax	96	303	205
Beer	208	262	54
	769	1,169	400
Spirits	64	115	51
Import Duties Act 1932 ...	16	37	21
Oil	111	144	33
Other*	116	145	29
Total*	1,076	1,650	574

10. The major changes are in the revenue from tobacco duties and Purchase Tax. It is usual to assume that apart from the smallest incomes there is not a very marked correlation between the consumption of tobacco and income so that with smaller incomes a greater proportion of income is paid as tobacco duties, and a similar remark applies to beer duties, but not to those on spirits. Purchase Tax is even more difficult to assess with the variations from tax-free utility goods to high rates of tax on luxuries; but as a first approximation it is probably true to say it is not so progressive as our present Income Tax. Shiras and Rostas in their "The Burden of British Taxation" estimate that in 1937-38 indirect taxation was regressive, representing 14 per cent. of income at £150 and 12 per cent. at £300 a year, which amounts might be considered as roughly comparable to £300 and £600 now. Within these amounts tobacco and alcohol taxes accounted for 74 per cent. of an income of £150 and 54 per cent. of an income of £300. Though the incidence of Purchase Tax may have modified these conclusions as to the relative incidence of indirect taxes it seems reasonable to suspect that the lower income classes which have had small relative benefits from the reductions in Income Tax are contributing relatively most towards the increased revenue from indirect taxation. Much of this indirect taxation can, of course, be avoided if one is prepared neither to smoke nor drink. This tentative conclusion applying within each grade of family responsibility probably requires modification when comparing single men and married men without children with those having children. It seems probable that family men spend less on tobacco and alcohol than those without such responsibilities. It may be that single men who have benefited relatively from reductions in Income Tax since 1945 have suffered relatively from increases in indirect taxation, though this is a measure of their ability to buy taxed goods.

* Adjusted slightly to obtain Exchequer Receipts rather than actual receipts in the total—for consistency with previous table.

SUPPLEMENTARY MEMORANDUM SUBMITTED BY MR. H. S. BOOKER

INCOME TAX AND INCENTIVE TO EFFORT

1. The article on "Income Tax and Incentive to Effort" was written in November, 1949[†] immediately after a new Government had anticipated its normal budget to announce income-tax reductions for the next financial year. One of the purposes of the reductions was to increase incentive by reducing tax on marginal earnings such as pay for overtime.

2. Two things in particular impressed me about the proposals, one being the enormous loss of revenue and the other the small decreases in the marginal rates of tax for most taxpayers. Quoting the article "The Modifications ... are estimated to cost £322 millions a year, which is about one-quarter of the present revenue from income tax" whilst a table showed that marginal rates for married couples with incomes of £400 or more were reduced by less than 1s. from 9s. in the £; for couples with £300 by only 5d. from 5s. 10d. Only for very limited classes of taxpayers were the reductions in marginal rates substantial. I could not see that the man who objected to extra exertion because the corresponding earnings were taxed at 9s. in

the £1 would willingly work harder if the tax were only 3s. and concluded "It is indeed difficult to see how incentive to effort can be greatly increased by such modifications in the rates of income tax except by budgeting for considerable losses in tax revenue".

3. The authorities, however, are persistent and have continued with "such modifications in the rates of income tax". Recently, six years after I wrote, another new Government made an early budget statement which announced income tax reductions intended to increase incentive. Again the cost is large; the reductions involve a reduction in tax revenue of £229 millions in a full year. The previous new Government introduced a three-tier system of tax rates, this one a four-tier system. Both increased personal allowances. And the new Government continued the policy of the old in increasing children's and earned income allowances.

4. The loss of revenue in 1952 was lower than the loss in 1945, largely because there was no reduction in the standard rate of tax. However, for this very reason the influence on marginal rates of tax has been primarily limited to those with incomes of less than £1,000 a year.

11. It is generally agreed that a high marginal rate of direct tax reduces incentive to efficient production, but it seems probable that a high rate of indirect tax on a marginal purchase may have a similar effect. If revenue from one hour's overtime is 5s., reduced to 3s. 6d. by direct taxation, is that very different from allowing the worker his full 5s. but increasing the indirect tax on his marginal purchase correspondingly, perhaps by making the price of a 3s. 6d. packet of cigarettes into 5s.? Surely the worker must ultimately realise that in either case the reward for one hour's overtime is a packet of cigarettes? If the tax system is to be progressive then the marginal rates of tax must be high, and this applies whether the tax is direct or indirect. If indirect taxation is a satisfactory substitute for direct taxation when incentive seems important it is because it is typically less progressive—as an example it is difficult to put an indirect tax only on the marginal packets of cigarettes, whilst it is easy with our present system to exempt the first £190 of income (for man and wife) for Income Tax. Our present attempts to make the indirect tax system progressive range from subsidies on basic foods, to tax-free utility goods and to high rates of tax on luxuries but they are clumsy and uncertain, whilst if they achieve their object they extend the problem of incentives beyond the field of direct into that of indirect taxation.

12. The relaxations of Income Tax since 1945 by their disincentivising effect and when associated with increased indirect taxation and rising prices have thrown a heavy burden on the people with the smallest incomes, especially those with families. It is an illusion to think that it is of severity and rising prices no harm is done to a group of people receiving a 10 per cent. increase in net income if all other people receive a 20 per cent. increase. Surely the policy has increased the legitimate grievances of those with incomes of less than £500 and has made it more difficult to resist claims for increased wages? It is unrealistic to think that the war-time concentration upon progressive direct taxation can be reversed so completely that comparison with the 1938 position is anything but nostalgic dreaming. There has been a marked reaction from the 1945 position as this note has attempted to show. To my mind the reaction has gone far enough so that I was pleased to see the reversal of the policy in the 1951 Budget.

1.5.1951.

* It was difficult to reconcile the Government's statement of February, 1944, that "It is essential therefore that there should be no further increase in the level of personal income" ... because, with certain qualifications ... "such an increase can only have an inflationary effect" with their action in the budget of April, 1944, when net earned incomes were increased by 33s. a week at £2,000 a year, 13s. a week at £1,000 a year whilst little or nothing was given to the family man with a typical £350 a year. There was 4s. a week for the single man with £350 a year. A "wage substitution" policy can hardly be a success when associated with this kind of action.

the £1 would willingly work harder if the tax were only 3s. and concluded "It is indeed difficult to see how incentive to effort can be greatly increased by such modifications in the rates of income tax except by budgeting for considerable losses in tax revenue".

3. The authorities, however, are persistent and have continued with "such modifications in the rates of income tax". Recently, six years after I wrote, another new Government made an early budget statement which announced income tax reductions intended to increase incentive. Again the cost is large; the reductions involve a reduction in tax revenue of £229 millions in a full year. The previous new Government introduced a three-tier system of tax rates, this one a four-tier system. Both increased personal allowances. And the new Government continued the policy of the old in increasing children's and earned income allowances.

4. The loss of revenue in 1952 was lower than the loss in 1945, largely because there was no reduction in the standard rate of tax. However, for this very reason the influence on marginal rates of tax has been primarily limited to those with incomes of less than £1,000 a year.

[†] The Commission had before them a copy of this article which was published in "Economica" in November, 1949.

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[Continued]

The proportionate loss of tax revenue from these classes has been enormous as Table I indicates, whilst the reductions in marginal rates are illustrated in Table II.

TABLE I

Proportionate loss in tax revenue from the 1952 Budget incomes all earned

Income per year before tax	Single Persons	Man and Wife	Man, wife and 1 child	Man, wife and 2 children
£	Per cent.	Per cent.	Per cent.	Per cent.
300 ...	37	53	—	—
400 ...	22	48	77	—
500 ...	22	29	56	90
600 ...	22	28	34	63
700 ...	21	26	35	43
800 ...	17	25	31	40
900 ...	15	20	29	36
1,000 ...	13	18	24	33
2,000 ...	7	8	10	12
4,000 ...	3	3	3	4

TABLE II

Rate of Tax per £1 of Income for Married Couples without Children

Earned income per year	Marginal tax		Average tax	
	1951-2	1952-3	1951-2	1952-3
£	s. d.	s. d.	s. d.	s. d.
250 ...	2 5	2 8	14	11
300 ...	4 5	2 4	6	3
400 ...	4 5	4 3	1 5	9
500 ...	4 5	4 3	2 0	1 5
600 ...	7 7	5 10	2 8	1 11
700 ...	7 7	5 10	3 5	2 6
800 ...	7 7	7 5	3 11	2 11
900 ...	7 7	7 5	4 4	3 5
1,000 ...	7 7	7 5	4 8	3 10

5. Once again the reductions in income tax have had relatively little influence on the marginal rates of tax when compared with reductions in tax revenue in the same ranges. (The table does not, however, show the most striking reduction in marginal rate from 7s. 6d. to 4s. 3d. for a small range of incomes just below £600 a year.) It is indeed doubtful if the budget has had any net incentive effect at all, for the changes in the marginal rate may have been completely neutralised by giving all people in the higher ranges an increase in net income of the order of 15s. a week irrespective of any change in their efforts. With increased incomes and unchanged leisure their natural tendency would be to sacrifice some of the income for leisure, obviously a disincentive.

6. My scheme is simply to make the short-run reward for additional effort much more substantial than it is at present, and to do it at negligible cost to the Exchequer by making the average rate of tax over periods of one year the marginal rate. Thus at present (1952-53) the man with a wife and no dependent children and £8 a week would retain 19s. of every £1 of additional earnings, with £12 he would retain 18s. and with £16 a week he would retain 17s. If single he would retain slightly smaller proportions (about 1s. in the £1 less); if with dependent children he would retain even more of his marginal earnings. Such a scheme would be consistent with the original terms of reference of the Royal Commission on Taxation of Profits and Income whereby it was to suggest improvements in taxation which would not involve loss of revenue to the Treasury. The Royal Commission was not to suggest the method which the Exchequer has been using almost consistently for over six years in reducing average rates of income tax.

7. It is interesting to note that successive budgets from 1945 to 1952 inclusive have sacrificed 50% or more of tax revenue from incomes up to £1,000 and the aggregate result is to reduce marginal rates of tax to almost exactly the same amounts as the introduction of my scheme would have done without the corresponding loss of revenue. For an example see Table III, but the effect can be seen better from a diagram.

TABLE III

Rate of Tax per £1 of Income for Married Couples without Children

Earned income per year	Marginal tax		Average tax 1945		Loss of tax Revenue
	1945	1952-3	s. d.	s. d.	
£	s. d.	s. d.	s. d.	s. d.	Per cent.
250 ...	5 10	—	1 36	—	100
300 ...	5 10	2 4	2 10	—	81
400 ...	9 0	4 3	4 0	—	66
500 ...	9 0	4 3	5 0	—	55
600 ...	9 0	5 10	6 2	—	45
700 ...	9 0	5 10	6 2	—	
800 ...	9 0	7 5	6 5	—	
900 ...	9 0	7 5	6 5	—	
1,000 ...	9 0	7 5	7 0	—	

8. In the same period the disincentive effects of increasing net income irrespective of effort have been marked: increasing by about 25% the net incomes of those people with gross earned incomes of £500 to £2,000 a year and increasing by about £300 the net incomes of those with gross incomes of £2,000 to £8,000 a year.

9. The method is to assess a person's tax at the beginning of a year (presumably the financial year) and let him know that the same rate will apply to any increased earnings in the year; that is to be his reward for obtaining the increased earnings. If his income rises because of increased productivity we ought not to begrudge the slight reduction in that person's tax compared with the present position. If the reason is not increased productivity the Commissioners of Inland Revenue must not set up as a moral tribunal; they cannot do more than accept the income as being justified in the judgment of whoever pays it.

10. I do not therefore recommend adjustments when a person's income rises during a year; that would partly reduce the effectiveness of the scheme. Nor, in general, do I think there ought to be adjustments downwards if income falls during the year, though in a transitional period, until the scheme became established, such adjustments would be fair for any year in which a person's income fell below the income of the year when the scheme started. Our present income tax is harsh on people with heavily fluctuating incomes; this scheme would benefit such people, and to give them additional benefits would be unfair to those with regular incomes. It does not seem necessary to provide special protection for those with fluctuating income, rather the reverse. (See note.)

11. Normally a person starts work with a small income, rises to a maximum and then may have a smaller income. So long as his income is rising he pays less tax than at present; if it falls he pays more but in general, over a lifetime, he would pay less tax than at present, partly because he pays tax for one year less. If, in one year, a man's income falls to a very small amount, his tax on that small amount must also be small and if the rate is high it means he must have had a large income in the preceding year and it is reasonable to try to collect the relatively small tax at the high rate. In exceptional hardship postponement might be appropriate. His position would have been far worse in the period when his whole tax was paid in arrears, and many people, under Schedule D, still make such payment in arrears and are expected to provide for it.

12. The transitional suggestions I make are to cover persons who have already attained a high income and have not had the benefits of the suggested scheme during the period of increasing income. In any year in which their income fell below that of the initial year of the scheme they should be assessed on the actual year's income, not the preceding year's.

13. For investment income normally taxed at the source there seems no reason to modify the method of tax collection, and such income would be ignored in calculating the appropriate rate of tax if the person appeared due to pay some tax at the full standard rate. If not, the tax

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[Continued]

rate would be reduced sufficiently on the basis of unchanged income to return whatever he could otherwise claim. Other income from property or work could be included in the assessment and could be taxed similarly through the person's code rate on the assumption that his income from the principal, taxed, source remained unchanged. Alternatively, in some cases of outside earnings, a person might be given an appropriate official tax rate each year and deductions made in accordance with the rate indicated on the card by the employer who engaged him temporarily. It is my objective, however, to assess the appropriate tax rate on the basis of a preceding year's income and not modify it if income changes in the year even if the change would produce an incidence of taxation markedly different from the present. I am not trying to copy the present system but to modify it in a way which, despite inevitable minor disadvantages, works in the aggregate better than the present one. It does not seem to me a disadvantage that a person should avoid tax in his first year of working, or when returning after a long period of unemployment or sickness. If a person marries, or if a dependent child is born, or if there is some other change in his circumstances then the rate of tax should be changed at the appropriate time in the year and not for the whole year, as at present, in whichever way is to the taxpayer's advantage.

14. My own feeling is that the big difficulty would be the administrative one of producing for every employed taxpayer an appropriate tax rate for the beginning of each financial year instead of simply a code number. The code number can be, and often is, changed. The new method would involve universal assessments, instead of assessments, apparently, in only one-eighth of the P.A.Y.E. cases. Presumably, however, the seven-eighths are straightforward cases involving personal allowances and one source of income only. It might be reasonable for all assessments to be made on the basis of the preceding calendar year for tax in the financial year, thus allowing tax offices three months in preparing tax rate codes. If delay is caused through people not completing the assessment forms, their tax rate could provisionally be fixed rather high with later adjustment.

15. I am not convinced that high marginal rates of tax have so serious a disincentive effect as many people think, but they have some influence. Moderate reductions in the marginal rate of tax such as are obtained by orthodox tax changes can have little influence upon whatever disincentive effect there is and lead to substantial losses of revenue. The most serious problem at present seems to be that income tax is our unpopular tax and much of its unpopularity is the general feeling of people that they

"pay tax at 9s. 6d. in the £1" or other rate which sounds high and hence objectionable. Despite this, income tax is a good tax and if it were more acceptable to people with moderate incomes we might not need the current drift from progressive income taxation to indirect and often regressive taxation. By this scheme an assessment is made of a person's capacity to pay tax at the beginning of the year in the light of his last year's income and his current year's responsibilities. That assessment says that in the circumstances it seems reasonable for the person to pay x shillings in the £1 as tax in the coming year only.

NOTE:—

Examples of Fluctuations (1952-53 Eamed income tax rates):—

Married couple, no children.

Average earnings £500 a year. Marginal rate from £400 to £600 is 4s. 3d. Normal tax is £37 a year.

Occupation	Present tax Average	Scheme
£	£	£
600-400	37	31
700-300	46	23
800-200	59	15
900-100	78	9
1,000-onl	96	nil

Suppose from £500 he has a good year, £700 earned:—

Present tax will change his payment for one year only and his net income will be £51.

The scheme would affect his payments for two years; in the first year his tax would increase to £51 (by £14) when his income was £700, and in the second it would be £62½ compared with a normal £37, an increase of £25½. Total increase is £39½ (say £40), or £11 lower than present tax.

Suppose from £500 he has a bad year, £300 earned:—

Present tax will be decreased by £33 in the year of poor income.

The scheme would reduce his tax by £15 and £21, i.e., by £36. As compared with present tax he again makes a saving.

If there are several good or bad years the principle is just the same, for the second such year would involve tax under the scheme exactly similar to the present tax.

26.5.1952.

EXAMINATION OF WITNESS

2284. *Chairman:* Mr. Booker, I am glad to see you. You sent us in, I think, two documents, one which you sent in in the early days of the Commission, and then a later one you sent us, a supplementary memorandum.—Yes.

2285. Have we got in those the substance of what you want to make by way of suggestion to the Commission?—Yes.

2286. Were you here this morning, because we had Mr. Hughes giving evidence then?—No, I was not here. I have seen a copy of the paper which he submitted.

2287. We have all read your memorandum through and we have it in mind. There may be one or two questions that we want to put to you to clear up what the nature of your suggestion is. You are impressed, as other people have been, by the disincentive effect you attribute to the present P.A.Y.E. system.—I think it certainly has some disincentive effect.

2288. Would it be fair to say the aspect of it which you find disincentive is the close relation of the marginal rate of tax to efforts to obtain an increased earning?—Yes, with in addition the fact that under P.A.Y.E. at present a person pays the full marginal rate on his additional earnings each week. It is brought to his attention immediately.

2289. I follow that. That is what I meant. You say it throws a spotlight on the presence of the marginal rate if it is reflected in his immediate weekly earnings?—Yes.

2290. And therefore what you are saying is it is to remove from his sight the immediate relation between the higher marginal rate and the increased earnings?—Mainly that. In addition I want to give the man who increases his earnings some real benefits as well by fixing the rate at which he should pay income tax through the whole of the following year at the beginning of the year.

2291. I wanted to get that quite clear. I think your proposal, as you explain it in the supplementary memorandum, is really to cut loose the man who is going to random, is really to cut loose the current income tax system pay this kind of tax from the current income tax system which will apply to other people?—Yes, I think that is fair comment.

2292. What I mean by that, so that we should not misunderstand each other, is this: you look at the income tax rate and allowances for the current year as laid down by the Act. You then look at his earnings in the previous year?—Yes.

2293. You then, applying those two things together, get a rate which the tax bears to his income so ascertained?—Yes.

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[Continued]

2294. And then you say to him "that rate will be all you will have to concern yourself with in the current year, that rate of tax will be taken off your earnings whatever they are week by week"?—Yes.

2295. And there is no further reconciliation or assessment at the end of the year at all?—In general, no. I think in one case it might be worth while having some reconciliation and that is over a transitional period at the beginning of any such scheme when a person has already attained his highest rate of earnings and is likely to have smaller earnings in future. Under this scheme a man gains if his income rises; in other words, he pays less tax than he would under the present scheme. If his income falls he pays rather more tax. If we take a man when he first starts work, he can expect his income to rise to a peak, then it may remain at that peak or it may fall off and the benefits which he gains while his income tax is rising will in general be rather greater than the loss he makes when his income falls. But if you start a scheme where a lot of people are on their maximum, and their income does fall off, then they lose by it without any compensating gains. I make some suggestions for covering that in this note.

2296. In your supplementary memorandum?—In my supplementary note.

2297. I think the members of the Commission will find it in paragraphs 11 and 12. That does not altogether take care of the trouble you might run into, does it, if you assess a person's rate on the basis of the earnings of the year before and then you find in the year following he was getting a good deal less. He would still be paying a high rate in relation to what he was currently earning?—He would be paying a high rate on small earnings.

2298. You would have to face this. You might have two people, one of whom for two years running had fairly small earnings, the other had high earnings in the first year but had sunk to the level of the other in the second year. On their current earnings, which are just the same, they would be paying a different rate under your scheme?—There is a note at the end of my supplementary memorandum which gives examples of what is likely to happen if a person's earnings fluctuate. I have taken as an example a married couple without any children with an average earned income of £500 a year. Under the present scheme he would pay £37 a year, this is rounded to the nearest £. If his income fluctuates so that he has, say, £800 one year and £200 the following year so that his average is still £500, under the present scheme he would pay an average tax of £39 a year. In other words, he is penalised for having a fluctuating income. Under my scheme he would benefit by it and would only pay £15; in other words, it pays a man to have a fluctuating income under this scheme.

2299. If you have in mind people who mainly think in terms of their weekly wage, must you not look rather more at the direct incidence of tax upon them than at the overall result over a long period?—People have got accustomed to make quite a lot of payments in arrears. Before the war the whole of income tax was paid a year in arrears and at present I think everybody assessed under schedule D, small shopkeepers and people like that, pay a year in arrears and if they have a high income one year they are expected to make provision.

2300. Of course, before the war the system was that you were paying the amount that was due by way of tax in the one year out of the current year's earnings. It was not the rate; it was the amount.—Before the war your tax was assessed at the end of the year and you paid it in the following year on both the rates and the amount appropriate to the earlier year and the burden of that was very much worse than the burden of this scheme of mine.

2301. Are you not troubled at all by the way your scheme would work out in a year of falling wages? You say you should make provision for cases of hardship; but a factor one has to take into account is how it would bear on the falling income.—I do not think over most typical incomes the position would be very serious.

2302. Do you contemplate making any special arrangement by way of allowance for hardship or anything like that, or do you think one could say it will not be a very

great burden and one can leave it as it is?—That is in general what I should feel like doing.

2303. Leave it as it is, how it falls?—Yes, but in special cases postponement of tax might be appropriate.

2304. Another point I would like to put in this, who do you contemplate under your scheme does the actual work of assessment, the employer?—No.

2305. The tax authority?—The Inland Revenue Department.

2306. They would do all the working out which would produce the appropriate rate for the individual who is to suffer the deduction?—Yes.

2307. Now if you base yourself on achievement on a previous year, you have either to find some achievement in that year or make some arrangement for imputing income to it, must you not?—I do not intend to impute any income for a year in which a person has no income.

2308. That is what I rather thought. I think your scheme is, that if you come into employment after a year in which you have had no income from wages, then for that first year you have no tax?—Yes.

2309. Does not that involve considerable revenue sacrifice?—A person works from, say, 15 to 65, 50 years. It is a question of a sacrifice of 2 per cent, if a person jumps immediately up to his maximum and remains at that maximum.

2310. I can see in many cases it is a boy first coming into employment?—In most cases.

2311. And probably a small element of tax involved anyhow. But you must envisage other cases where through illness or other reasons a person has had no appreciable earned income in the earlier year?—If a man has had no appreciable earned income through illness or unemployment I think most people would not grudge him having a certain amount of time to settle down after his misfortune.

2312. I quite follow that view. You think although he might be getting a good earned wage in the year in question there are arguments for ignoring that and letting him have his first year, in effect, free?—I think so.

2313. When you fix the rate which is to be the rate for the year, the fixed rate, you really have to contemplate assessing everybody who is in gainful employment?—Certainly everybody whose principal source is gainful employment; probably everybody with gainful employment at all.

2314. Perhaps assessment is not the right word. You would have to have the tax authorities discovering the position of, and if necessary assessing, everybody who is in gainful employment?—I do not see that that is any different from the position at present. Everybody in gainful employment is assessed now.

2315. I think if one uses the word "assessed" strictly a very large number of people are not, are they? You do not proceed to assessment under the PAYE scheme?—I understand. You are talking of people under PAYE who are given a code number and that takes care of their income and income tax throughout the year and they are not effectively assessed. My scheme means those people have to be assessed. On the other hand, I think those people will be people where the assessment is a straightforward assessment, being nearly all people with one source of earned income only and it is simply a question of making assessment on that one figure in conjunction with their allowances.

2316. One has to envisage an administrative task, the size of which one cannot estimate, under which you try near the beginning of the current year to deal with the tax position of all these people?—I think the administrative task is the biggest snag with my proposal.

2317. You probably cannot give it any order of magnitude, but one recognises it is a very big task, is it not?—Yes, I mention it in my supplementary memorandum.

2318. You mention it in paragraph 14, I think?—That is right.

2319. My own feeling is that the big defect would be the administrative one of producing for every employed taxpayer the appropriate tax rate for the beginning of each financial year instead of simply a code number; universal

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[Continued]

assessment would be involved in the new method. One last question. It is to some extent found that these particular elements of PAYE to which you draw attention have a disincentive effect. Can you verify that by practical experience?—I think it is extremely difficult to prove it one way or the other. I think most people with major employment, with a job, think in terms of this being a job to be done and if it involves overtime or extra effort they accept it without thinking in terms of the marginal rate of tax they will have to pay. I think when a person has an opportunity of making extra earnings from a source rather outside his major job that this disincentive effect is significant. I think it is also significant among married women and people who like, but do not need, a job and tend to earn up to the amount at which they become liable to tax, and then feel "I am not going to work any more than this". I think the general objection to income tax which is apparent nowadays arises from a feeling that the rate is high and the objection is more psychological than any other effect. The difficulty with which people say they are paying tax at 3s. 6d. in the £ when probably their average rate is 2s. 6d. or 3s. 6d. is an example.

2320. That is perhaps a dramatic way of expressing their feeling that income tax is high anyway?—Yes.

2321. Of course, as long as you keep a system of progressive taxation at all there is a possible disincentive effect in any reduction of it, the more you earn the higher tax you have to pay. You will not eliminate that because you put it back into the previous year?—I think that is inevitable with a form of progressive tax.

2322. Mr. Woodcock: I think Mr. Booker's paper is clear enough and I think from what he has said he is quite right about the disincentive effect, therefore I have only one question on the last paragraph of his article published in "Economica." You say:

"It might be argued that although the man who works overtime does not lose immediately any substantial portion of the overtime in tax, he does lose in the long run."

and you agree this argument is certainly correct, but you say:

"Psychologically the position under the suggestions made in this paper is very different from that under PAYE."

That is fair enough, but do you not think there is something to be said for the position in which at the end of the week a man knows he has paid up, and does in fact pay up his income tax liabilities? Is there not some psychological advantage in that?—You are suggesting under my scheme he does not pay up his liabilities at the end of the week?

2323. That is your suggestion?—My suggestion is he does pay his current liabilities when he has paid his 2s. 6d. in the £ on whatever he has earned in the week.

2324. I am taking your own statement where you say:

"It might be argued that although the man who works overtime does not lose immediately . . ."

that is under your scheme,

" . . . any substantial portion of the overtime in tax, he does lose in the long run."

You say that might be argued against your scheme, and you agree that is certainly correct. Under your scheme he does pay his tax but may take longer to pay it?—Under my scheme if he increases his earnings substantially in one year he will pay at a higher average rate in the next year.

2325. He is really always behind with his tax under your scheme?—He is not behind at all. His appropriate rate is fixed at the beginning of the year and that is the rate for the year, and if in that one year he increases his earnings he pays in that year at a slightly lower rate than he would under the present PAYE system.

2326. Then at the end of the year he will really have something to pay in respect of that which he will have to pay in the following year; it affects his rate?—It

affects his rate in the following year and he will only have to pay that rate in the following year.

2327. And you say it might be that the man would think he was escaping his tax under your scheme?—There is that element in it.

2328. That might be advantageous, but under PAYE the man does know when he gets his wage that he is clear of liability; he is free for all time?—It is the same in my scheme. When he has paid the tax at the end of the week he is free of liability to tax on that income. What happens is that at the end of the year a person's earning power is assessed on the basis of what he has earned last year and on that earning power it is reasonable for him to pay at a rate of, say, 2s. or 2s. 6d. in the £ on his income in the following year.

2329. Mrs. Aunty: Do you consider the disincentive effect of the high marginal rate is the chief defect in our present system? You have singled it out to discuss. I wondered if you thought it was one of the chief defects or was it rather that you took an interest in it?—I think it is a defect, but I do not think it is the chief defect in our current system of taxation.

2330. You do not take it as seriously as all that?—No.

2331. You gave the case of the disincentive to the married woman who would work until she became liable to tax, but that would not be any different under any system in which you had an exemption. If it is a case of passing from no tax to being taxable you would not get rid of that by reducing the high marginal rate of taxation. In regard to the married woman who does not want to earn enough to become taxable, is there any disincentive in that case beyond the fact that the tax has to start at some point?—None. At present tax would start at the 3s. rate and the effective tax would be 7/9ths of 3s. i.e. at 2s. 4d. As soon as she comes into the tax rate at present she pays 2s. 4d. on every additional £ she earns. Under my scheme she would not pay anything in the first year. Then in the following year she would pay at 2d. or 3d. on every £ she earned, and if then her earnings went up she would still be paying 2d. or 3d. on the additional £'s for that year. It has a slightly different psychological effect I think.

2332. To married women as a whole, I suppose putting the husband's and wife's earnings together for taxation purposes, it is a much bigger factor than this particular type of disincentive?—Yes.

2333. One other point. It was suggested, I think by the Chairman, that there would be a loss to the Revenue because there was no tax paid in the first year of beginning to earn. Would it be your view there would be nothing to set off against that? If you are paying on the last year's income you go on paying a year longer so there would be some ultimate loss, but you think it is worth while to have that ultimate loss?—I think so.

2334. Because it will be small?—I suggested it might be about 2 per cent. of the total revenue.

2335. There would be no offset?—There would be a slight offsetting in that people whose incomes were falling would pay rather more than they would at present, but it would not compensate.

2336. Mr. Crick: If questions have been put on this point please forgive me. I came in late and I apologise for that. Will you look at the table in paragraph 1 of your first memorandum? It is on that table I should like to put to you one or two questions. You are seeking here to establish an observation about the trend of changes in taxation which diverges from general impression to some extent and it is very important that this table should provide convincing evidence on the point. Now in that table you compare equal gross incomes for two years with an interval of about five years between them?—Yes.

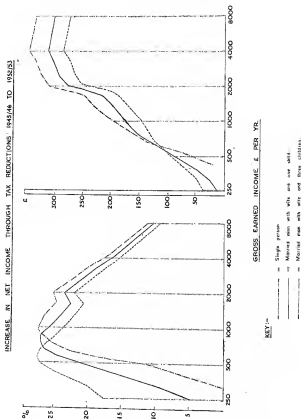
2337. In your second table in paragraph 3 you acknowledge that in the heading where you say "assuming gross income unchanged". Now that would be convincing in a period of stable price levels and on the whole stable pattern of incomes?—Yes.

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[Continued]

Graph handed in by Mr. H. S. Booker.
[See Question 2354.]



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[Continued]

2338. Is it equally convincing in a period which as we know has not fulfilled these conditions?—In general I think it is. Incidentally I have a graph which in effect shows those figures brought up to date, including the effects of the current year's budget. On the right hand side of the graph I take different incomes, e.g. £350, £500, £1,000, £2,000, £4,000 a year and measure the effects of the reductions of income tax on people with those levels of earned income. You will see that with incomes of £2,000 a year or more there has been a net reduction in taxation of the order of £250 to £300 a year or more with much smaller reductions for people with smaller incomes. I ought to explain that the three different lines relate to a single man, a married man with one dependent child and a married man with three dependent children. The trends are all similar. The other way of looking at the problem is to note the effect of the tax on the man's net income expressed as a percentage, and this is attempted in the graph on the left which shows that for incomes of from £500 a year up to £2,000 a year the effect of reductions in tax has been to increase net incomes by about 25 per cent. (say 20 to 27 per cent.) in ranges £500 to £2,000 a year earned income with smaller increases for people with less than £500 and above £2,000. Of the total number of incomes in the country about 5 per cent. are above the £1,000 level which gives an idea of the size of the problem involved. This increase of about 25 per cent. for incomes of £500, £700 up to £2,000 has gone a long way to compensate for the rise in the cost of living among these classes even if they have not had an increased money income during that period, and that effect is far less marked for what I call typical working class incomes of up to £500 or perhaps a little more, especially where there are dependents. It has been necessary for these people to demand increased wages to keep them relatively in a similar relationship to those with rather higher incomes because of the results of income tax. Have I made my point fairly clear?

2339. Yes. It does not altogether dispose of my difficulty I am afraid. You would agree, for instance, looking at the first table in your original document that the number of earned incomes of £350 was very much larger in 1945 than it was in 1951-52?—I should imagine so. If a typical earned income was about £300 in 1945 it is about £400 in 1951-52.

2340. I do not recall the index but let us work on that basis. Would you not agree the whole distribution of income has shifted upwards with different degrees of shift at different levels of income?—The whole distribution has shifted upwards. I am not convinced that the shift has benefited any particular broad class markedly more than any other broad class since 1945, but I very much doubt if there is any real evidence to show what has happened.

2341. The shift has been substantial, has it not, in the general distribution of incomes?—We are comparing 1945 with 1951?

2342. Yes.—I do not think we have any evidence that the distribution has shifted at all. The total amount of income has increased.

2343. But in belts of income, let us say from nil to £200 and then from £200 to £500 there has been a shift all the way along the range from the lower to the higher incomes, has there not, so that the numbers in the bottom belts have diminished and the numbers in the upper belts have increased?—Yes.

2344. That would be true, would not it?—Yes.

2345. If that is so and you want to present a proper picture of the shift in net incomes after tax, should you not compare a smaller gross income in 1945 with a larger gross income in 1951-52 and then allow for the change in the price level? In other words, should you not take account of that shift in the pattern of incomes from smaller denominational levels into larger denominational levels?—In so far as we can do it, yes. I think it is an extraordinarily complicated task.

2346. It is complicated; but do not you think this type of table presents too simple a picture, inasmuch as it implies that as many people are getting £350 as before,

and therefore the figures in that particular line of the table leading up to 14 per cent. are as significant and important as they would be if you had had no change in the pattern of incomes at all?—I do not agree that it invalidates this general comparison that I am making. I think it would be better if we could express incomes in terms of a constant price level and probably express taxation as a proportion of income for each income group, but if I did it would still show much the same effect I think, that is that the reductions in income tax which have taken place since 1945 have benefited people I call the middle classes very much more than they have benefited the working classes.

2347. That is your impression?—That is my impression.

2348. But you cannot statistically establish it?—It seems to me that it is established when we show that at £1,000 a year, a married man with one child, has had an increase in his net income of 25 per cent, whereas at £350 a year he has had an increase of only 15 per cent, as a result of changes in income tax.

2349. That would not be true if, for instance, there was nobody with an income of £350 now, would it? That is the extreme point. If you concede me that, then it follows it is less true if the number of people with £350 a year has diminished over the period.—If the number with £350 a year has diminished the number with £400 a year has not diminished but has increased and it would be more true then.

2350. You do not give a figure for £400, and the whole difficulty in my mind is that this table does not take account of the redistribution of incomes to start with. However, what I wanted to get from you was the impression that that does not invalidate the conclusions you draw from this table?—I could certainly have put in a whole series of additional values in money terms which show the same kind of trend.

2351. Do you think it is quite impossible to construct a table that would take account of the shift in the distribution of incomes?—I think we are arguing a bit at cross-purposes. On a shift in the distribution of incomes, you are referring just to the inflation that has taken place, the increase in money incomes?

2352. Yes.—My feeling is the distribution of incomes has not changed greatly since 1945. What has happened is that money values of all income have gone up.

2353. *Sir Harry Gill*: Mr. Booker was quoting very extensively from a graph. It was quite impossible for any of us to do more than follow his voice. I wonder if he would agree he should put the graph in and we could all have it to examine?

2354. *Chairman*: You might hand it round so that everybody can see what you are referring to. I daresay we could arrange to have it printed later. (*Graph handed in; reproduced at page 206.*)

2355. *Mrs. Anstey*: Might I ask a question. When I looked at the table my impression was it was intended to indicate that between £350 a year and £1,000 the percentage in the third column was rising and then it began to fall again so that I thought you had merely put in the £350 figure without any intermediate figures in order to save space. Was that correct? I thought it was an upward trend from 14 per cent. up to the 13 per cent. and from 18 per cent. it went down again. Is that a fair assumption?—That is the assumption and the graph shows it has happened.

2356. It is not the case that if you put in the £400 it would go a different way. It is simply that you shortened the table but the tendencies are as shown?—Yes.

2357. *Mr. Woodcock*: What you show is what you would naturally expect if taxation was reduced anyhow?—When income tax is reduced, but of course what has been happening ever since 1945 is there is evidence of people objecting to income tax and the reductions in income tax have been balanced by increases in indirect taxation.

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[Continued]

Income tax is proving an unpopular tax at present and my feeling in general is it is a good tax and it is a pity it should be unpopular and that successive Chancellors have striven to reduce income tax when it necessitated increasing indirect taxes.

2358. *Chairman*: I follow that, but what is fact should the Commission deduce from that so far as its work goes? We cannot deal with indirect taxes?—So far as that is concerned my own impression is that part of the reduction of income tax has been because of the feeling that the rate of tax is very high and I think that if my scheme was introduced and people were paying at the rate

of 2s. or 3s. in the £, there would not be this objection to income tax. My aim is to make income tax a rather more popular or less unpopular tax than it is at present.

2359. I follow that, too, and therefore the theme which this table is directed to is really to support your view that the way to make income tax more popular is to make it a fixed proportional rate ascertained on the last year's achievement?—Yes. I think that is probably a greater argument in favour of the scheme than the pure incentive effect.

Chairman: Thank you very much for your help to the Commission.

The witness withdrew.

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MINUTES OF EVIDENCE

TAKEN BEFORE THE

ROYAL COMMISSION ON
THE TAXATION OF
PROFITS AND INCOME

NINTH DAY

Thursday, 12th June, 1952

WITNESSES

SIR RICHARD SNEDDEN, C.B.E.

MR. DAVID J. YOUNG

MR. E. M. AMPHLETT, M.C.

MR. F. J. C. HONEY

MR. M. Y. COBB, M.B.E.

MR. J. H. KIRLING

MR. G. P. S. MACPHERSON, O.B.E.

PROFESSOR F. W. PAISH

} British Employers'
Confederation

Questions 2360-2449

} Issuing Houses
Association

Questions 2450-2553

Questions 2554-2633



LONDON: HER MAJESTY'S STATIONERY OFFICE
1952

THREE SHILLINGS NET

TERMS [OF REFERENCE
(As amended 11th March, 1952)

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages: to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer: to consider the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden fairly among the individual members of the community: to make recommendations bearing in mind that in the present financial situation it may be necessary to maintain the revenue from profits and income: and, in so far as they make recommendations which would on balance entail a substantial loss of revenue, to indicate an order of priority in which such recommendations should be taken into consideration."

NOTE

For the guidance of intending witnesses the Commission published a list of the main heads under which evidence was invited. They explained that the list was not necessarily exhaustive and that witnesses could put in evidence on questions not specifically mentioned, provided that they fell within the Commission's terms of reference. The list is reproduced below.

A. General social and economic questions

1. Is the present system of taxation satisfactory, or could it be improved, in relation to :—
 - (a) incentives,
 - (b) risk bearing,
 - (c) encouraging savings,
 - (d) the control of inflationary or deflationary tendencies,
 - (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment,
 - (f) its effect on the distribution of personal incomes,
 - (g) other economic and social objectives?

These questions can be considered in relation to the taxation of :—

- (i) salaries and wages (P.A.Y.E.),
 - (ii) profits of businesses and self-employments,
 - (iii) dividends and other sources of income.
2. Would it be advantageous to link Income Tax with social security payments and contributions?
3. Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

B. Particular matters

4. Is the taxation net drawn too widely or too narrowly in relation to :—
 - (a) the taxation of United Kingdom residents (companies or individuals) on overseas profits,
 - (b) the taxation of non-residents on United Kingdom profits,
 - (c) the definition of residence, etc.?
5. (a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particular—
 - (b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?
6. Is the basis of computing income from property under Schedules A and B satisfactory?
7. Should the present rules about deductions for outgoings and expenses be altered?
8. Are the provisions for relief in respect of double taxation satisfactory?
9. Should the present system of graduation by means of the exemption limit, personal allowances, reduced rate relief and Surtax be altered?
10. Should the existing differentiation between earned and unearned income be extended or reduced?
11. Are alterations necessary in the rules governing personal and other allowances?
12. Should the rules about the taxation of husband and wife be altered (a) as regards aggregation; (b) in any other respect?
13. Should P.A.Y.E. be altered or abolished?
14. Should the principle of deduction at source be extended or restricted?
15. Should the method of assessment to Surtax be altered, and in particular should it be deducted from salaries?
16. Are any alterations desirable in the system of administration and the functions of the various statutory bodies or persons connected with taxation?
17. Are any changes in the provisions against avoidance and evasion desirable?
18. Is any alteration necessary in the rules governing the taxation treatment of special classes of taxpayers (e.g., public corporations, co-operative societies, charities)?

THE ROYAL COMMISSION ON THE TAXATION OF PROFITS AND INCOME

NINTH DAY

Thursday, 12th June, 1952

PRESENT:

The Rt. Hon. LORD RADCLIFFE, G.B.E. (Chairman)

MRS. VERA ANSTY, D.Sc.

MR. H. L. BULLOCK

MR. W. S. CARRINGTON, F.C.A.

MR. W. F. CROCK

MR. J. E. GREENWOOD

SIR GEOFFREY HEYWORTH

MR. N. KALDOR

MR. W. J. KIRWICK

MISS L. S. SUTHERLAND, C.B.E.

MR. G. WOODCOCK

MR. E. R. BROOKES (Secretary)

MR. D. G. DAYMOND (Assistant Secretary)

Sir RICHARD SNEEDEN, C.B.E., Mr. DAVID J. YOUNG, Mr. E. M. AMFLETT, M.C., Mr. F. J. C. HONEY and Mr. M. Y. COBB, M.B.E., on behalf of the British Employers' Confederation; called and examined.

MEMORANDUM SUBMITTED BY THE BRITISH EMPLOYERS' CONFEDERATION

I. INTRODUCTORY

1. The Royal Commission on the Taxation of Profits and Income was appointed in December, 1950, with the following Terms of Reference:—

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages; to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer; to consider the present system of distributing the tax burden fairly among the individual members of the community; and to make recommendations consistent with maintaining the same total yield of the existing duties in relation to the national income."

The Confederation has noted that forms of taxation other than those on profits and income are excluded from the Terms of Reference of the Royal Commission, and that, as regards the taxation of profits and income, the Commission is limited to making recommendations consistent with maintaining the same total yield of the existing duties in relation to the national income.

2. The Confederation is the central Employers' Organisation dealing with labour questions arising out of the relationship between Employers and their workpeople. While, therefore, the Confederation has given careful consideration to the list of points to which the Royal Commission has asked that evidence should be directed, the following Memorandum sets out the views of the Confederation in regard to those aspects of the Commission's inquiry which seem to fall within its purview.

II. PRESENT SYSTEM OF TAXATION IN RELATION TO DISTRIBUTION OF PERSONAL INCOMES

3. Despite the limitations imposed by the Terms of Reference of the Commission, the Confederation feels that, in considering the effect of the present system of the taxation of profits and income on the distribution of personal incomes, it is necessary to view the matter against the background of the total amount raised by all forms of taxation, and the principal heads of national expenditure.

The following Table contrasts the central Government taxation levied in 1938-39—the last complete pre-war year—with the Budget estimates for 1951-52.

TAXATION LEVIED BY CENTRAL GOVERNMENT

(Derived from Financial Statements presented to Parliament in April, 1939, and April, 1951)

Tax	1938/9		1951/2 (Budget Estimates)	
	Yield of Tax	Percentage of Total	Yield of Tax	Percentage of Total
Income Tax	£ mill. 336	Per cent. 37	£ mill. 1,625	Per cent. 46
Surtax	63	7	128	3
N.D.C., E.P.I. and Profits Tax	22	2	312	8
TOTAL	421	46	2,065	51
Death Duties	77	9	180	5
TOTAL DIRECT TAXATION	498	55	2,245	56
Purchase Tax	—	—	310	8
Other Customs and Excise	340	38	1,341	33
Other Taxes (Motor Vehicles, Stamp Duties, etc.)	68	7	138	3
TOTAL	906	100	4,034	100

4. It will be seen from the above Table that the total central Government taxation has increased from £906 millions in 1938-39 to the prodigious figure of £4,034 millions in 1951-52. Although the total national income—as estimated in the Government's White Paper "National Income and Expenditure of the United Kingdom" (Cmd. 8203)—has increased from £5,253 millions in 1938 to £11,970 millions in 1950, and may have increased further to some £12,500 millions in 1951-52, the proportion of the national income taken in central Government taxation has increased from 17 per cent. to 32 per cent.

In that connection it should be borne in mind that the above Table does not include the contributions of Employers and Insured Persons to the National Insurance Scheme, amounting in 1950 to £198 millions and £242 millions respectively. Whatever view may be taken as to the appropriate classification of the contributions of Insured Persons, it is clear that the contributions of Employers constitute a tax on employment. Further, the above Table does not include the Rates levied by Local Authorities, amounting in 1950 to £338 millions.

5. It will also be seen from the Table that in 1938-39 the total yield of the taxes on profits and income was £421 millions, while in 1951-2 the estimated yield is £2,065 millions—nearly five times the 1938-39 figure. During the same period the proportion which these taxes bear to the total tax revenue of the State has increased from 46 per cent. to 51 per cent.

12 Jan., 1952]

SIR RICHARD SNEDDEN, C.B.E., MR. DAVID J. YOUNG,
 MR. E. M. AMPLETT, M.C., MR. F. J. C. HONEY AND MR. M. Y. COBB

[Continued]

The corresponding increase in Income Tax alone is from £336 millions to £1,625 millions or from 37 per cent. of the total to 40 per cent. of the total. In that connection it may be noted that the imposition of Profits Tax itself reduces the yield of Income Tax—since the amount paid in Profits Tax is treated as an expense for the purpose of assessing Income Tax—and if there were no Profits Tax the yield of the Income Tax in 1951-2 would amount to some 44 per cent. of the total tax revenue.

As regards Surtax, it will be noted that, while the yield has been approximately doubled since 1938-9 and the combined rates of Income Tax and Surtax rise to 19s. 6d. in the £ on the higher slices of personal income, the contribution which Surtax makes to the total amount of tax revenue has actually decreased from 7 per cent. to 3 per cent. since 1938-9.

6. The following Table compares the principal items of central Government expenditure in the Budget Estimates for 1938-9 with the corresponding items for 1951-2.

ESTIMATED ORDINARY EXPENDITURE OF
 CENTRAL GOVERNMENT

(Derived from Financial Statements presented to Parliament in April, 1938, and April, 1951)

	1938/9		1951/2	
	Expenditure £ mil.	Percentage of Total Per cent.	Expenditure £ mil.	Percentage of Total Per cent.
DEFENCE ...	256	27	1,274	30
NATIONAL DEBT ...	230	24	535	13
SOCIAL SERVICES:				
Old Age Pensions, Unemployment, Sickness, Assistance, etc. ...	139		248	
Education ...	60		252	
War Pensions ...	40		85	
Housing ...	18		60	
Health Services ...	1		398	
Family Allowances ...	—		63	
FOOD SUBSIDIES ...	258	27	1,106	26
GENERAL GRANT FOR LOCAL SERVICES ...	—		403	10
STRATEGIC RESERVE ...	55	6	56	1
OTHER SERVICES ...	145	16	143	4
OTHER SERVICES ...	—		680	16
TOTAL ...	944	100	4,197	100

DISTRIBUTION OF PERSONAL INCOME, BY RANGES OF INCOME BEFORE TAX, 1938-39 AND 1949-50

(Derived from "National Income and Expenditure of the United Kingdom, 1946 to 1950"—Cmd. 8203)

Range of Income before Tax	1938/9				1949/50			
	Number of Incomes	Total Incomes before Tax	Total Tax	Tax as Percentage of Incomes	Number of Incomes	Total Incomes before Tax	Total Tax	Tax as Percentage of Incomes
Under £250 ...	—	2,259	£ mil.	Per cent.	—	£ mil.	£ mil.	Per cent.
£250— ...	1,890,000	631	30	0.2	—	2,209	24	1
£300— ...	539,000	361	19	3	10,310,000	3,546	186	5
£1,000— ...	183,000	247	45	11	2,443,000	1,614	239	15
£2,000— ...	98,000	361	105	29	545,000	728	189	26
£10,000 and over ...	8,000	163	94	58	219,000	760	324	43
TOTAL ...	—	4,322	397	7	—	9,047	1,106	12

10. It will be seen that, while in 1938-9 the proportion of income levied by Income Tax and Surtax increased steeply for the higher ranges of income, the graduation increased with much greater severity in 1949-50. No figures are yet available for 1951-2, but in considering the above Table it must be borne in mind that since 1949-50 the rates of Income Tax have been increased and that the personal allowances—which have the greatest weight in the lower income groups—have also been increased, with the result that the steepness of the graduation shown in the above Table for 1949-50 has been still further accentuated since that time.

As an illustration of the extent to which taxation of the higher income groups has been carried, it was pointed out by the Chancellor of the Exchequer in his address to

7. It will be seen that the expenditure on Defence has risen from £256 millions in 1938-9 to £1,274 millions in 1951-2—some £500 millions of that amount being due to the additional charge resulting from the Government's Rearmament Programme—and that the cost of the National Debt has increased from £230 millions to £535 millions.

As regards the Social Services, it will be seen that the payments from the national Exchequer have increased from £258 millions in 1938-9 to £1,106 millions in 1951-2. In that connection it should be borne in mind that these figures do not fully reflect the increased cost of the National Insurance Scheme, since a higher proportion of the cost of this Scheme is now borne by the contributions of Employers and Insured Persons than was the case in the comparable Schemes in 1938-9.

It will also be seen that, as compared with 1938-9, a new item of Food Subsidies, amounting to over £400 millions, appears in the 1951-2 expenditure.

8. The Confederation considers that the redistribution of personal incomes which has taken place since before the War has been materially contributed to not only by the taxation of incomes but by the whole pattern of taxation levied by the State and by the direction of State expenditure, as disclosed by the foregoing Tables.

On the taxation side, for example, Purchase Tax, which did not exist in 1938-9, and is estimated to yield some £310 millions in 1951-2, itself has a definite redistributive effect in that higher rates of tax are imposed on those classes of goods which are more likely to be purchased by persons in the higher income groups.

On the expenditure side, individuals in the lower income groups benefit to a much greater extent in proportion to their income than those in the higher income groups from the Government expenditure on Social Services of over £1,100 millions, and from the Food Subsidies of over £400 millions.

9. As regards the redistribution of personal incomes effected by the taxation of profits and income, the following Table illustrates the changes effected between 1938-9 and 1949-50 by Income Tax and Surtax.

the Trades Union Congress in September last that if all the excess net income over £2,000 a year were taken by the Treasury it would bring in only a further £53 millions in tax.

11. While direct comparison between 1938-9 and 1949-50 is rendered more difficult by the fall in the value of money which has occurred in the interval, it will be seen that the increase in the number of incomes in the higher income groups is very much less than those in the lower income groups. For example, while the number of persons with incomes of £2,000 a year or more in 1949-50 was slightly more than double the corresponding number in 1938-9, those with incomes of £250 to £500 a year in 1949-50 were more than five times as many as in

12 June, 1952]

MR. RICHARD SPODGEN, C.B.E., MR. DAVID J. YOUNG,
MR. E. M. AMFLETY, M.C., MR. F. J. C. HOSSEY AND MR. M. Y. COBB

[Continued]

1938-9. It is therefore clear that, quite apart from taxation, the gross money incomes of the lower groups have increased to a considerably greater extent than those of the higher groups.

12. It will thus be seen that, since the war, a number of factors have been operating to bring about a redistribution of income from the higher to the lower income groups.

The Confederation realises that the only one of these factors falling directly within the Terms of Reference of the Royal Commission is that of the taxation of profits and income. The Confederation considers, however, that it would be unrealistic to consider the effects of that factor in isolation without having regard to the repercussions arising from the other factors operating in the same direction.

In the opinion of the Confederation, the full effects of these factors have not yet materialised since there must inevitably be a considerable time-lag—amounting in some instances to one or two generations—before the national economy has fully adjusted itself to their operation. The Confederation submits, however, that the foregoing Tables demonstrate clearly that a stage has already been reached in the graduation of income tax and surtax when it is impossible to effect any material lightening of the burden on the lower income groups by any further transfer to

the higher income groups, and that the only remedy for the existing situation is a substantial reduction of public expenditure which will permit of a corresponding reduction in the burden of taxation as a whole.

III. PRESENT SYSTEM OF TAXATION IN RELATION TO INCENTIVES

13. Under the existing Income Tax legislation and rules, the liability to tax is calculated on the amount of "taxable income" found by deducting from the gross annual income various allowances, the principal of which—so far as concerns the great majority of employees—are the Earned Income Allowance of one-fifth of the income (subject to a maximum of £400) and personal allowances of £110 for a single person, £190 for a man and wife, and £70 for each dependent child.

The first £50 of "taxable income" is then taxed at 3s. 6d. in the £, the next £200 at 5s. 6d. in the £, and the remainder at 9s. 6d. in the £.

14. The following Table shows—taking account of the above allowances and of the fact that the family allowances of 5s. 6d. per week in respect of the second and subsequent children are taxable—the approximate level of average weekly earnings at which persons with various family responsibilities become liable to tax at 3s. 6d., 5s. 6d. and 9s. 6d. in the £.

APPROXIMATE MAXIMUM WEEKLY EARNINGS UP TO WHICH NO TAX, OR NO TAX AT THE HIGHER RATES, IS PAYABLE
(1951-52 Financial Year Basis)

	Single Person	Married Man and Wife	Married Man and Wife with—				
			1 Child	2 Children	3 Children	4 Children	5 Children
No tax payable	£ s. 2 16	£ s. 4 15	£ s. 5 8	£ s. 7 17	£ s. 9 6	£ s. 10 14	£ s. 12 3
No earnings taxed at rate higher than 3s. 6d. in the £	4 0	5 19	7 12	9 1	10 10	11 18	13 7
No earnings taxed at rate higher than 5s. 6d. in the £	8 16	10 15	12 8	13 17	15 6	16 15	18 3

15. It is clear from the above Table that the effect of taxation in relation to productive effort will operate with different intensity on different individuals according to their average level of earnings and family circumstances. Moreover, taxation is only one of a number of factors operating in the economic field.

In these circumstances, no precise measure of the effect of taxation on workpeople as a whole can be given, but, from the information which has been received by the Confederation, the Confederation has no doubt that the weight of existing taxation does tend to discourage effort on which increased output depends.

16. The effect of taxation is most clearly noticed by workpeople when there is a change—however temporary—in their level of earnings. Since the steps in the rates of tax involve progressively higher taxation on each additional slice of income, the effect is marked when workers go on overtime for a week.

When this occurs, the worker tends to note the proportion which his normal weekly tax bears to his normal wage, which he regards as his normal tax rate, and has the impression that the additional overtime earnings are taxed at a higher rate than on any portion of his normal earnings even though the overtime earnings do not in fact attract such higher rate of tax. Where the worker's normal earnings take him close to the limit of a particular tax rate, the additional payment for overtime is in fact taxed at a higher rate than any portion of his normal earnings, and the reaction on the worker is accentuated.

17. Overtime hours are normally paid for at an enhanced rate, but in many cases the actual or apparent incidence of tax on overtime earnings gives the worker the impression that he is actually receiving a lower hourly net rate of pay for his overtime hours than for his normal hours.

The result is, therefore, that in many industries the incidence of taxation is an important element in discouraging workers from undertaking overtime. This is particularly the case with single men, or married men without children, whose the overtime earnings may well attract tax at the full standard rate (less earned income allowances).

18. While discouragement from overtime working appears to be the most widespread effect of present taxation, the Confederation has also had difficulties brought to its notice in regard to the fixing of piece-work rates or the introduction of a bonus incentive scheme.

Such schemes are in general desirable to encourage maximum productive effort, but the workers—or their representatives—tend to measure the net additional earnings after deduction of tax resulting from such schemes against the additional effort necessary. The result has in some cases been pressure by the workers for rates which would be uneconomic.

19. Another effect of present taxation is to narrow the differentials between skilled and unskilled workers. This factor does not yet appear to have had any material effect in limiting the supply of persons willing to undertake the training necessary for skilled work. It is nevertheless a problem which may well assume increasing importance in the future, if the existing high rates persist.

IV. OPERATION OF P.A.Y.E.

20. The principal effects of taxation in relation to discouraging effort appear to be the results of the high rates of taxation themselves, but the method of collection of the tax is a factor, and the Confederation accordingly desires to submit the following views on that aspect of the matter—

12 Jan., 1952]

SIR RICHARD SNEEDEN, C.B.E., MR. DAVID J. YOUNG,
MR. E. M. AMSHURLEY, M.C., MR. F. J. C. HOSNY AND MR. M. Y. COBB

[Continued]

21. Before the introduction of P.A.Y.E. in 1944, there had for some three years been in operation a system of tax deduction from weekly wages. Under that system, Employers were required to send in half-yearly returns of the earnings of their manual workers to the Tax Offices and they were then notified of the amount of tax to be deducted from each employee during the first 24 weeks of a half-year, any amount which could not be deducted during this period being deducted in the remaining 2 weeks of the half-year.

This system led to many difficulties. The tax deductions were not related to current earnings and in seasonal industries, where the tax resulting from a period of high earnings might require to be deducted during a period of comparatively low earnings, this led to trouble. Further, much delay and inconvenience in effecting appropriate tax deductions arose when workers changed their jobs. The system, indeed, had a bad effect on production in that it encouraged workers in some industries to change their jobs frequently with a view to tax evasion.

22. The Confederation appreciates that if substantial sums are to be levied by way of direct taxation on the general body of manual workers some system of tax deduction from weekly wages is essential.

The Confederation regards it as imperative, in any such system where the machinery of the employer is used to effect the deductions, not only that the volume of work imposed on the employer should be kept to a minimum, but that the employer shall make the deductions in accordance with instructions from the Tax Authorities and shall in no way be placed in the position of assessing the tax due. In particular, no employee should be required to disclose his domestic affairs to his employer. Any infringement of that principle might lead to serious impairment of industrial relations.

23. The introduction of P.A.Y.E. in 1944 observed those principles and avoided many of the difficulties experienced under the previous system. The amount of tax to be deducted is broadly related to current earnings, evasion of tax is reduced to negligible proportions, and, while Employers are involved in a large volume of routine work, the system has, on the whole, worked smoothly and involved few difficulties.

In that connection, the Confederation welcomed the full consultation which was accorded it by the Inland Revenue Department before the introduction of the system and which has continued ever since when there has been any proposal for a modification. The Confederation is convinced that such consultation has proved of great value both to the Inland Revenue Department and to Employers in providing a smooth working and effective system.

24. The most important element in the present system of P.A.Y.E. is perhaps the cumulative principle.

Under that principle, on the occasion of each payment of wages, the total of the employee's earnings from the beginning of the Income Tax Year is taken into account, that the total tax due for that period is calculated by reference to Tax Tables which are based on the assumption that the average earnings since the beginning of the Income Tax Year will persist during the remainder of that Tax Year.

Where weekly earnings fluctuate, this principle has the broad effect of relating higher deductions of tax to the weeks in which higher earnings are received, but it also results in a tendency to accentuate the incidence of tax in weeks of high earnings. This accentuation is particularly noticeable where additional earnings are paid as a result of overtime having been worked, and may have a pronounced effect on the apparent incidence of tax on the additional earnings when the previous average earnings were near the point at which a higher rate of tax begins to operate, especially during the early part of the Income Tax Year.

25. A further effect of the cumulative principle is that, if in any week earnings fall substantially below the previous average, it may result in a refund of tax. This is no doubt a desirable feature in cases of sickness or involuntary unemployment. Unfortunately, it may also encourage voluntary absenteeism and even provide a subsidy to workers engaged in a strike.

26. While, therefore, the major effects in discouraging productive effort result from the high rates of tax themselves, and not from the method of collection of that tax, the Confederation is of opinion that the P.A.Y.E. system does tend to accentuate certain of these effects, and the Confederation has accordingly examined a number of proposals for varying the existing system.

27. The most important of these proposals for varying the existing system would provide that each week's pay would be taxed by itself on the assumption that the man's yearly earnings will be in proportion to the earnings in that tax week. This method would reduce the volume of the Employer's work by avoiding the necessity for calculating the cumulative earnings from the beginning of the year but it would produce an approximation to the correct amount of tax during the year only where there was little fluctuation in earnings from week to week. This condition does not apply to the great majority of manual workers and, in all cases of fluctuating earnings, the effect of the method would be to lead to over-deduction of tax and the necessity for a periodical refund, either by employers or by the Inland Revenue Department.

28. It appears to the Confederation that, if this method were adopted, it would have the following effects:—

(a) Where there were substantial fluctuations in earnings, not only would there be over-deduction of tax, but the periodical refunds of tax would, in a number of cases, amount to a considerable sum, and payment in a lump sum might encourage absenteeism at the time of the refund with detrimental effects on production.

(b) The incidence of tax in a week of additional earnings would not be diminished as compared with the present system, and in most cases its effect would actually be increased.

(c) The automatic refund of tax now payable under P.A.Y.E. in cases of sickness would be lost and, if it were thought necessary to retain this feature of the existing system, it would require special provision with considerable complications.

29. The Confederation has also examined a number of other proposals for effecting deductions of tax from earnings. One group of such proposals, under which the Income Tax and Social Security systems would be linked, is examined in the following section of this Memorandum. Some other proposals contain ingenious devices for remedying certain of the disadvantages of the existing system. After careful consideration, however, the Confederation has come to the conclusion that all such proposals which have come before it contain other features which would be disadvantageous and on balance would not lead to more satisfactory results than the present system.

V. LINKING OF INCOME TAX AND SOCIAL SECURITY SYSTEMS

30. The existing Income Tax and Social Security systems, whilst operating under separate enactments and administered entirely separately, have certain features in common in that both make provision by way of allowances for varying family circumstances.

In the case of Income Tax, the personal allowances to be set off against income are increased for married men and for each dependent child and also for certain other dependent relatives, and the allowance therefore takes the form of a reduction in the amount of income tax which would otherwise be chargeable, the value of the allowances to an individual depending upon his total income and the rate of tax which that income bears.

In the case of the Social Services, a family allowance of 5s. 0d. a week is payable in respect of the second and each subsequent dependent child irrespective of whether the claimant is employed or not. In addition, persons in receipt of retirement pensions, sickness benefit, unemployment benefit or injuries benefit are entitled to an allowance for a dependent wife or husband (or certain other dependent relatives if there is no dependent wife or husband), with further allowances for dependent children. These allowances take the form of cash benefits payable weekly at fixed rates.

12 June, 1952]

MR. RICHARD SMEDDEN, C.B.E., MR. DAVID J. YOUNG,
MR. E. M. AMULETT, M.C., MR. F. J. C. HONEY AND MR. M. Y. COSS

[Continued]

31. It may be noted that the conditions under which the allowances are made under the two systems are not identical. For example, under the Income Tax system, a married man is normally entitled to the increased personal allowance in respect of his wife even though she is employed and earning a substantial income, while the allowance for a dependent wife under the National Insurance Acts is not payable if the wife is earning more than 20s. 6d. a week (40s. 6d. a week in certain circumstances). It will also be noted that, under the National Insurance Acts, weekly contributions at a fixed rate are payable by employers and workers, self-employed persons and non-employed persons, and that in the great majority of cases benefit is dependent upon certain contribution conditions.

32. During recent years, a number of proposals have been put forward for merging the Income Tax and Social Security systems. These proposals, while varying considerably in detail and the extent to which the merger would in fact be effected, all aim at simplification of administration, particularly as regards income tax.

Under these proposals, all the personal allowances under the Income Tax system would be abolished and weekly cash allowances would be substituted. Further, the reduced rates of income tax would be abolished and income tax would be levied at a flat rate, either on all earned income or on all earned income up to a certain limit, e.g. £500 or £600 a year, with higher rates on income above the limit.

33. There is also considerable variation between the different proposals as to the rates of the cash allowances and the conditions in which they would be paid and also as regards the flat rate of income tax to be charged on earnings.

For instance, under one proposal, the Social Services would not be substantially modified, but tax would be chargeable on earnings up to £500 at a flat rate of 3s. 6d. in the £, while cash allowances—to replace the existing personal allowances—would be payable only to married men, and a single person would lose the value of his existing personal allowance.

Under another proposal, while the flat rate of tax would be 6s. 8d. in the £, weekly cash allowances would be payable to all individuals, except possibly where they were "voluntarily unemployed", and the conditions attached to the receipt of benefit under the Social Security system would, in general, be rendered unnecessary.

Under other proposals again, while all individuals would be entitled to a weekly allowance, this would be supplemented in the event of sickness, unemployment, industrial injury, etc., and it would appear that the main administrative machinery of the National Insurance Acts would require to be maintained.

The various proposals also differ in their treatment of contributions under the National Insurance Acts. Under some proposals these contributions would be continued, while in others they would be merged with general taxation.

34. The Confederation has examined these schemes from the employer's point of view and has given particular attention to their effect on incentive to effort by workers in industry, on industrial relations and on the volume of work involved for employers.

35. While the adoption of a flat rate of tax might remove some of the discouraging effect of the present progressive rates of taxation, the imposition of tax at a high rate on all earnings would be likely to have serious repercussions.

For example, a rate such as 6s. 8d. in the £ charged on all earnings—which would be involved in those schemes aiming at a complete merger with the Social Security arrangements—would in the opinion of the Confederation prove a very strong discouragement to productive effort and would be quite impermissible. In that connection, it should be noted that a substantial number of workers are not liable to income tax under present arrangements and all such workers would be required to pay a substantial proportion of their earnings in tax. While they would also receive a direct cash allowance, this would be divorced in the minds of the workers from the tax deducted from their earnings and would not mitigate the discouraging effect of the taxation itself.

36. The same considerations would apply, though not with equal force, if the flat rate of tax adopted were, say, 3s. 6d. in the £. It appears, however, that such a rate would only be practicable if the cash allowance to be paid in lieu of the existing personal allowances did not extend to single persons. Under such a scheme, while the total amount of taxation (less cash allowances) might approximate to the total amount at present collected in tax up to the income limit adopted for the operation of the new rate, there would inevitably be a considerable shifting of the burden between individuals and the single person would bear a heavier load than at present.

In view of the fact that the discouraging effect of the existing income tax system in the field of industrial employment is probably greatest in the case of single persons, it is not easy to estimate the net effect on all workpeople of the proposal and it may well be that on balance there would be little advantage.

37. The Confederation is also strongly of the opinion that those schemes which involve a higher rate of tax on income over a certain level would introduce a new discouragement of additional effort when that level was about to be reached. This effect would be greater than in the case of changes to a higher tax rate under the present system, since it would bring the tax-payer into a different class and would apply to all workers whose earnings were near the upper limit of the flat rate of tax, irrespective of their family circumstances.

The Confederation is therefore convinced that there would be a marked tendency for workers to limit their earnings so as to avoid payment of the higher rate of tax.

38. A further difficulty of these schemes lies in the fact that all earnings, however small, would be subject to tax.

Under existing Regulations, an employer is not required to deduct tax from an employee whose earnings do not exceed £3 a week, though he should notify the Inspector of Taxes if the earnings exceed £1 a week and he has reason to think that the worker has other employment. This provision is of great administrative convenience, both to employers and the Inland Revenue, in regard to casual and part-time workers, not only in industry but also in domestic employment.

Under the proposed schemes, small earnings could not be ignored—to do so would bring the law into disrepute and would cause grave dissatisfaction amongst other classes of workers—but the administrative arrangements necessary to ensure that the appropriate tax deductions were made would cause great difficulty.

39. So far as concerns those proposals under which separate weekly contributions under the National Insurance Acts would be abolished and the cost of the Social Services would be financed out of general taxation, the Confederation appreciates that there would in some cases be an improvement in the incentive to work. The cases which the Confederation has in mind are persons who are available to take up a limited amount of part-time work but for whom the existing National Insurance contribution forms a strong deterrent since it absorbs a substantial proportion of the earnings. From the employer's point of view also the employer's contribution, which is payable for any employment over four hours a week, may render such part-time employment uneconomic.

In such cases, therefore, the abolition of weekly contributions would be an advantage. It should, however, be pointed out that the abolition of all National Insurance contributions is not the only way to obviate the difficulty in regard to part-time workers to which the Confederation has referred, and the Confederation understands that the question of contributions in relation to part-time workers is at present under consideration by the Ministry of National Insurance.

40. The Confederation would also point out that the abolition of National Insurance contributions would involve a fundamental change in the whole conception of the National Insurance Scheme. The Confederation does not appreciate that the contributions themselves are not sufficient to finance the benefits under the National Insurance Acts and that large contributions are necessary from the National Exchequer, in particular to finance retirement

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pensions. Nevertheless, the Confederation attaches great importance to the maintenance of the principle in the National Insurance Scheme that the right to benefit should be related to the payment of contributions, and the abolition of weekly contributions would necessarily carry with it the abolition of all existing contribution tests for the receipt of benefit. This would entail not only an immediate increase in cost through the payment of benefit which would be withheld under existing rules, but would also tend to encourage extravagance in the Social Services by giving the impression that benefits are financed by the State out of a bottomless purse, and by removing the existing objective test of relating the value of the benefits to the value of the contributions, leaving the level of benefits to be determined on purely political grounds.

41. So far as concerns the abolition of the existing income tax allowances and the substitution of weekly cash allowances, the Confederation would also point out that under existing income tax law there are a number of allowances, such as tools allowances, industrial clothing allowances, and life assurance relief, which would either be ignored under the new proposals or would involve additional cash allowances with consequent difficulty of administration. The Confederation appreciates that, in the case of the great majority of manual workers, the value of these allowances is comparatively small but it feels that their abolition would be strongly resented by the workers concerned and that in some cases (e.g. tools allowances) their abolition would result in demands for increased wages.

42. As regards the effect on industrial relations of the various proposals, this would largely depend on how the amount of the weekly cash allowances is to be determined and the arrangements for their payment. It was pointed out in paragraph 22 that the Confederation would regard it as essential that the employer should in no way be placed in the position of an assessor nor should the worker be obliged to reveal his family circumstances to his employer.

If arrangements were to be made for these allowances to be paid otherwise than through the employer, the necessary administrative machinery would be likely to show little saving over the existing system. Nevertheless, for the reasons given above, the Confederation would regard it as entirely inappropriate that the machinery of the employer should be used for the payment of family allowances, and is of opinion that such an arrangement would have serious repercussions on industrial relations.

43. From the point of view of the volume of work involved for the employer, it would appear that the normal weekly operation of tax deduction would be somewhat simpler than under the existing system, provided that the employer was not in any way involved in the payment of the weekly allowances. Such saving would, however, be offset to some extent if the flat rate of tax did not operate throughout the whole range of earnings, and supplementary tax had to be deducted by the employer from employees' earnings over some limit such as £500 or £600 a year. The volume of work entailed by a two-fold system of this nature is difficult to estimate in the absence of precise details of the proposals but it would appear to the Confederation that it would be unlikely that any material saving would result in the volume of work to be performed by the employer.

44. In view of the foregoing considerations, the Confederation is unable to recommend any of the various proposals for linking the Income Tax and Social Security Systems which have been put forward because on balance they would be detrimental to productive effort and industrial relations and would unnecessarily increase the existing pressing burden of taxation.

VI. OTHER MATTERS

(a) Deductions from Taxable Income for Outgoings and Expenses

45. So far as concerns the matters falling within the purview of the Confederation, few difficulties in regard to deductions from Taxable Income have been brought to the attention of the Confederation.

Certain difficulties have, however, been experienced in various industries in regard to expense allowances for industrial clothing and tools. While manual workers in a number of industries have established claims for these allowances, it would appear that the amount of the allowances varies in different areas, and it is felt that there should be a review of the position by the Inland Revenue with a view to establishing a uniform policy. Further, many clerical and staff workers also experience heavy wear and tear on their clothing, which must be replaced at their own expense, but a comparable allowance is not normally made by the Inland Revenue in their case. It is felt that this anomaly is not justified and should be removed.

46. The Confederation would also wish to refer to difficulties arising when employees are sent abroad, often to areas where living conditions are unhealthy or unpleasant, when high salaries have to be paid to induce employees to accept such posts.

Under existing Income Tax law, such employees are subject to British Income Tax unless they are resident outside the United Kingdom for the whole of an Income Tax Year. A man may therefore be employed abroad for a period of nearly 2 years and still be liable to British Income Tax throughout the whole period.

This anomalous position is causing great difficulty in obtaining staffs for overseas contracts and may result in the loss to this country of both the prestige and the benefits accruing from the foreign currencies earned by contracts of this type.

The Confederation would therefore urge that workers sent abroad on such contracts should be afforded a tax-free allowance or equivalent concession to compensate for the conditions under which the work must be carried out.

(b) Additional Steps in Graduation of Tax

47. The Confederation has considered whether any advantage would be afforded if additional steps in the rates of tax were introduced.

It would appear that the introduction of further steps would produce a less severe effect at each step, but more workers would be brought into the position where tax on overtime earnings would be payable at a higher rate than the tax on their normal earnings, and the discouraging effects of differential tax rates on extra effort would occur more frequently than at present.

In these circumstances, the Confederation has come to the conclusion that that course would be unlikely to effect any material lessening of the discouragement of extra effort, and would merely tend to add a further complication to the tax system.

(c) Differentiation between Earned and Unearned Income

48. The form which differentiation between earned and unearned income takes under the existing law is a tax-free allowance of one-fifth of the earned income, subject to a maximum allowance of £400.

The net result of the allowance is to reduce the effective rate of tax on earned income as compared with that on unearned income. Since the principal discouraging effects of income tax on effort appear to result from the present high rates of tax, the Confederation approves this reduction in the effective rate.

(d) Rules for Taxation of Husband and Wife

49. The aspect of the Rules for taxation of husband and wife with which the Confederation is concerned is their effect on the incentive to work of husband and wife.

Under the present Rules, the income of a wife living with her husband is normally regarded for tax purposes as the husband's income but in addition to the usual allowances granted in respect of the husband's earnings and earned income allowance of one-fifth in respect of the wife's earnings, the following further concessions apply in respect of the wife's earnings:—

(i) an additional allowance of four-fifths of her earnings, up to a maximum additional allowance of £110;

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(ii) further reduced rate reliefs in respect of the taxable balance of her separate earnings, after deducting allowances particular thereto and any balance of the husband's allowances not absorbed by his own income.

The latter concession was introduced in 1948. Before that date, reduced rate reliefs only applied to the aggregate earnings of the husband and wife, and did not apply to them separately. The alteration was thus a valuable concession in encouraging married women to take up employment.

The Confederation is of the opinion that the present Rules for taxation of husband and wife are satisfactory so far as incentive to work is concerned. There is some evidence, however, that the concessions which apply in respect of a wife's earnings are not widely known amongst the general public, and the Confederation therefore considers that the recruiting of married women into industry would be assisted if more publicity were given to the Rules.

VII. CONCLUSION

50. The Confederation would reiterate that it is strongly of the opinion that the present high level of Income Tax results in a significant discouragement of effort; that the P.A.Y.E. method of collecting tax itself tends in some respects to discourage effort but that the Confederation is unable to recommend any of the variants on that method which have so far come to its notice; and that the Confederation is opposed to the adoption of any of the various proposals for linking Income Tax with the Social Security system.

51. Finally, the Confederation desires to place on record its view that the effects of the present high level of direct taxation will only become fully apparent over a period of years; that the perpetuation of high rates of direct taxation will inevitably have serious repercussions on the industrial efficiency and productive capacity of the country; and that the only remedy is a substantial reduction of public expenditure which will permit of a corresponding reduction in the burden of taxation as a whole. 8. 10. 1951

DOCUMENT HANDED IN BY THE BRITISH EMPLOYERS' CONFEDERATION GIVING REVISED
TABLE OF INCIDENCE OF TAX. THIS TABLE REPLACES THAT GIVEN IN PARAGRAPH 14 OF
THE MEMORANDUM. [See Question 2369.]

APPROXIMATE MAXIMUM WEEKLY EARNINGS UP TO WHICH NO TAX, OR NO TAX AT THE HIGHER RATES, IS PAYABLE
(1952-3 Financial Year Basis)

	Single Person	Married Man and Wife	Married Man and Wife with—				
			1 Child	2 Children	3 Children	4 Children	5 Children
No tax payable	£ s. 3 3	£ s. 5 7	£ s. 7 9	£ s. 9 3	£ s. 10 17	£ s. 12 11	£ s. 14 5
No earnings taxed at rate higher than 3s. 0d. in the £	5 12	7 17	9 19	11 13	13 7	15 1	16 15
No earnings taxed at rate higher than 5s. 6d. in the £	9 6	11 11	13 13	15 7	17 1	18 15	20 9
No earnings taxed at rate higher than 7s. 6d. in the £	13 1	15 5	17 7	19 1	20 15	22 9	24 3

EXAMINATION OF WITNESSES

2360. Chairman: We are grateful to you, Sir Richard, and your colleagues for the paper you have sent us and for coming here today. May I just clear my own mind and see whether I follow the theme of the opening paragraphs of your paper, taking it quite shortly. First of all you direct our attention to the increase in the volume of taxation since 1938-39 and you point out that the total of central Government taxation has increased, that a paragraph 4, from £906 millions to the prodigious figure of over £4,000 millions in 1951-52. That means the volume of the taxation on profits and income among other things has gone up very largely and the proportion of national income taken by that kind of taxation has increased too?—Sir Richard Sneed: Yes.

2361. That is your theme down to paragraph 5?—Yes.

2362. And then in your table in paragraph 6 you analyse some of the main heads of Government expenditure for which that taxation is taken and you point out that there has been a very great increase in some major heads like defence, the service of the national debt and the social services. That takes us to paragraph 7, and then in paragraph 8 you have a point about the incidence of the purchase tax, with its concessions and its level of charge on the luxury goods, and about the social services showing that they may bear with different proportions on different kinds of income?—Yes.

2363. And they tend to bear, in your view, I have no doubt they are intended to, less heavily upon the lower income. Then we get your table in paragraph 9 and you are showing there, as between the pre-war year 1938-39

and 1940-50, certain ranges of income and the total contribution that the various persons in those classes make, the total tax taken from them and the percentage which the tax bears to the total income. Of course in all of them we see over the period that there has been a greater percentage of the income taken by way of tax in all classes. Your table does not study the proportional increase of the various rises?—No.

2364. A rise from 5 per cent. to 5 per cent. by itself in the £250-£500 class is a greater, I suppose, proportionate rise than 11 per cent. to 15 per cent. in the next class or 18 per cent. to 26 per cent. in the third?—Yes.

2365. You have not worked out what the various proportional rises are?—No, we have not.

2366. I cannot do it myself. The theme as you go on in paragraph 10, that looks at the share of the higher incomes which is taken by this form of direct taxation, is that it has become a much higher share of the total income since the war?—Yes.

2367. And anybody would describe it as being very heavy. Now may I take you to paragraph 12, there is a question I wanted to ask you to enlarge upon a little. You have drawn attention to the factors I think I have summarised and then you say in the middle of the paragraph:

"In the opinion of the Confederation, the full effects of these factors have not yet materialised since there must inevitably be a considerable time lag—amounting in some instances to one or two generations—before the national economy has fully adjusted itself to their operation."

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What have you in mind particularly when you say that?—I think this whole, may I use the word "disincentive" though I dislike it myself, this whole disincentive effect is I think cumulative. As the weight of taxation gets heavier or as it remains heavy and continues people get more and more discouraged. I think that is really what we mean by that. You may get reconciled to heavy taxation after a time but that reconciliation does not take into account what you might have done if you had not the heavy weight. It is all speculative but that is our feeling, your back begins to bend and you can never straighten it again. That is the underlying theory.

2368. In your reference to generations, do you draw a distinction between the older people with habits they have acquired under less onerous taxation and the newer generation which has never known anything different?—I would not go the length of generations myself. I would make it shorter than that. May I make a few preliminary remarks. I wondered if you would want to know whether we wanted to change our evidence or supplement it in any way in view of the changed terms of reference. We have consulted our members and the answer is "no." Secondly, we have got a table on taxation in paragraph 14 which of course is very seriously modified now as the result of the Budget and we have a revised table if you would like us to hand it in.

2369. If you have a revised table it is convenient that we should have it in terms of the present Budget?—We have it here. Some of the other figures are changed but I do not think we need worry about that. Last of all I should explain we do not represent nationalised industry. In saying that I do not count iron and steel as being nationalised for this purpose. (Document handed in; reproduced at page 209.)

2370. Now you have given us your new table which corrects the figures for the current Budget proposals, does it alter the general effect of the evidence in your paper?—I do not think so. It is very difficult to say what effect this is going to have. It is of course putting more work-people out of the income tax range and to that extent it may modify the disincentive effect. On the other hand wages have gone up and earnings have gone up with these in the last year so the difference between the old table and the new may not be so great as it appears to be, but the general effect I think is still what we have put down in our paper. There is no doubt at all that this makes a married man with family responsibilities better off from the point of view of taxation and that of course from this limited point of view is a help.—Mr. Amfletter: May I add a word on that. Personally I should say the recent Budget has gone slightly in the direction that we envisaged that taxation might be changed when we drafted this report, it has gone partly in that direction in that it has introduced a further step and has relieved a larger number of people from taxation at all. It is a move in the direction of lightening the load of taxation on certain people.

2371. I rather gather from paragraph 47 of your paper that you do not see any very great advantage in increasing the steps in the lower ranges?—Sir Richard Sneed: This is one step, there has been one step introduced. That I think is all to the good. What we were thinking of when putting forward this memorandum was the total yield of taxation and you were not going to get anywhere by altering the grades. You are merely going to put it on to somebody else possibly lower down, but that does not apply to the new arrangement. We welcome the step certainly.

2372. On the question of the marginal rate affecting the person's readiness to put out more effort bringing in more reward, what is your general view about the introduction of a number of slight steps in the progression?—It is extremely difficult to be dogmatic about this question of deterrent effect. So long as there is any deduction at all I think the average workman feels that something is being taken from him, and in particular, his overtime is being penalised. We may be able to prove to our own satisfaction that this is not the case, but everyone talks about the effect of taxation on incentive and the more you talk about it, the more the effect becomes. It becomes a sort of habit of mind. You cannot prove it statistically. I notice your own predecessor, I think,

asked for a concrete witness. You cannot really tie people down. You can get a man to come and say to you in your office "I do not want to work overtime because income tax is taking it all from me, let us get back on my hourly rate". If you press him you might find he was wanting to be at home that night, he was wanting to go to the dogs, he was wanting to look at television or something like that. There will always be some other reason as well and you can never tie these cases down, but I do not think anyone who is in industry would deny that there is a general disincentive effect whatever the rate; the higher the rate the greater the disincentive.

There is the other point, and here I am speaking personally, when you come down to a low rate of tax, and that is whether it is not wise from the point of view of public policy that everyone should pay some amount of tax however small, even though the cost of collection is more than the amount brought in, but that is a personal view, I should not like that to be taken as the view of the British Employers' Confederation.—Mr. Amfletter: May I add a point on this question of disincentive. I think there is one element that we are liable to overlook, and it is this; that a large number of work people, I am talking of wage earners of course primarily, a large number of work people get into the habit of working to a budget and though they may object to taxation being deducted, in course of time they get used to it. They are paid and the time required to earn that amount of money becomes more or less accepted. You have got to bear in mind if there were to be a sudden reduction in taxation it would enable that element among the wage earners to reach their necessary budget with less work and you might temporarily have a reduction in the amount of work that is done. I think we have to remember that.

2373. Does that mean you find on the whole that the man thinks in terms of the net receipt he is going to get from his work?—You cannot generalise; the work motive behind the mass of the work people in industry is a variable. Some work because they must, some work because they want to earn enough to maintain a certain standard of living, some work because they want to earn enough to buy something extra above their present standard of living, and some, and I feel it is the very large majority, work because it is the natural and proper thing to do.

2374. I think then we may take it that your point in paragraph 15 really stands as you put it there.

"No precise measure of the effect of taxation on work people as a whole can be given, but, from the information which has been received by the Confederation, the Confederation has no doubt that the weight of existing taxation does tend to discourage effort on which increased output depends".

That is dealing with the weight.—Sir Richard Sneed: Weight as opposed to the system.

2375. Then in paragraph 17 you deal with the specific questions of overtime, piece work and bonus schemes. You say there:

"In many industries the incidence of taxation is an important element in discouraging workers from undertaking overtime".

That is derived from actual experience of particular industries?—What we did, we sent out a questionnaire based on the questions asked by this Commission and we got replies from the vast majority of our members and that is what this memorandum is based on. Do you want me to deal with the question of exempting overtime which is often put forward?

2376. I should be grateful to have your views.—It is of course a very attractive idea, this exemption of overtime earnings from taxation, but we think it is utterly impracticable and we think it would be quite unfair to apply it. Industries are quite variable in the way in which they reckon overtime hours. There are some industries, for example, where you have to work, shall we say, the normal hours of eight before overtime operates. In other cases overtime operates at a certain time on the clock whether you have in fact worked before that or not. Then you have the difficulties of Saturday and Sunday working in shift industries where that sort of working is quite frequently normally not overtime at all, and we do not see how you can exempt overtime which is additional work from

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taxation without trying to do something for the various incentive bonus schemes and piece work schemes and that sort of thing, because that means additional production, increased effort within the normal hours. It would cause considerable uproar throughout industry if you singled out one particular type of extra work for exemption from taxation and did not deal with the others. You have got office staff who in many cases get a salary which includes overtime. Many offices have seasonal overtime and that is included in the general annual salary. I hesitate to think what would happen in industrial negotiations if you say that overtime is going to be exempt because you would get some pretty unusual claims for reduction of hours. I think those are sufficient reasons. I do not think that the word "overtime" is generally understood outside industry. People have the general idea that once you have worked a certain period the rest is overtime. That is not how it works at all, and while there is a great deal of attraction about the idea, I am bound to say all our knowledge goes to show the thing would be utterly impracticable.

2377. I am much obliged. Have you had under consideration schemes that have been mooted to scotch what is called a "normal" working week and then remove tax from anything that involves labour in excess of that?—No, we have not.

2378. I rather gather from what you say that you would not regard it as a practicable proposition?—We would look at anything, but I think we should need a good deal of convincing.

2379. Then you go on in Part IV of your memorandum to bring us closely down, apart from questions of weight of taxation in a progressive tax system and its grades, to the method by which P.A.Y.E. is worked today, and then you raise a point in paragraph 22, I do not know if you would like to enlarge on it at all. You say you think it very important that in any tax system the employer should have no assessing responsibility himself at all, but should merely be an instrument for the work of the Inland Revenue. That is the effect of what you are saying?—I would put it higher than important. I think it is no part of our job, and I think it would be most unfortunate if we were asked to do any calculations at all from the point of view of actual assessment. Our job is merely to act as agents and do what we are told in this particular instance and we have no desire to take over any of the other functions of the Inland Revenue.—Mr. Amphlett: May I add there, it is not only a question of our taking over functions, but I think it would be psychologically wrong that the employer is placed in the position of having to look into the domestic affairs of his work people.

2380. There are two aspects, the question whether it is right at all that the employer should take any responsibility, and secondly, you feel it would not help labour relations if you were asked to enquire?—Sir Richard Sneed: We have nothing to do with the man's domestic circumstances and responsibilities. That is really what it comes to.

2381. I think we sent you a week ago a short paper which has been prepared for us about the American withholding system.* Have you had a chance of giving it any study?—We have given it a little study, the name attracted me, "withholding" tax, but I take it it does not mean quite what it appears to mean. Mr. Young is Chairman of our Taxation Committee, and may like to reply.

2382. I think that under that system, this is my impression, the question of the exemptions which the employee claims on the grounds of personal circumstances remains for the current year a matter between himself and the employer until he files his claim and to that extent it is a disclosure by the employee to the employer of his personal circumstances?—Mr. Young: I can see no advantage in that, over the system which has been worked out here. I tended, in reading this, to think that a comparison of the organisation of the Inland Revenue and the organisation of the Tax Collecting Authorities in America showed that our organisation is somewhat more advanced and our present method better. I would not have thought that the Americans would have chosen their system had they found it possible to adopt the British one. Sir Richard Sneed: There is an indication at the end of paragraph 5

of this summary that in some cases the employer from his own knowledge does interfere with the employee's claim for exemption certificates.

2383. There is a suggestion that the fact that the employer may know the circumstances of the employee would be a check upon the claim that the employee was making for personal exemption?—That is the point.

2384. But it is a much simpler system, it is not, for the employer to work, in the sense that the tables he has to operate are much more simply conceived?—Mr. Young: Largely, almost entirely, due to the fact that it is not a cumulative system. Apart from the fact that it is not cumulative I think there is no question that the American organisation is a less effective one than the British and not one that we would like but there is, of course, the question of the principle of cumulative deduction.

2385. And you appreciate that the American system appears to involve universal assessment after the end of the year of all employees; withholding is merely a provisional arrangement?—Yes.

2386. Is there any attraction from the employer's point of view in having the simpler tables to work on?—We would welcome simpler tables but we are not at all sure that we welcome doing away with the cumulative system. The disadvantage of the cumulative system is, from an employer's point of view, a tendency of work-people to take a short period off knowing they will obtain an advantage in taxation, but if the American system were adopted we would have to visualise that there would either be an over-deduction of the individual or under-deduction. If there was over-taxation then he would have a very large sum returned and he might take a much longer period off. If you had under-taxation he would suffer from a sense of frustration or a sense of grievance and that would be a bad thing. The view of my Committee which dealt with this is that the present income tax system which is cumulative has certain disadvantages, but the fact that it is basically a just system, that in practically every case justice is done and done promptly, has tended to make it possible to collect the large sum of taxation which is at present collected in this country with the minimum of interference with industrial relations. We either tend to think that where it hurts, shall I say, a resistance, a kind of thick skin has grown over those points and it is now considerably well understood by the employee and we would think that if the Inland Revenue following Government policy has to collect the same amount, the present system, being basically a just system, should not be materially altered.

2387. Would there be, in your view, an additional difficulty from the fact that having started with the system more just and considerate it might be more difficult to change over to the simpler but less considerate system?—I should think that in so far as people benefited by it there would be no difficulty. In so far as they did not benefit there would be considerable difficulty. We only have to deal with that proportion of the employees who have a sense of grievance and no advantage would accrue from those who benefited by any change.—Sir Richard Sneed: May I add on that last point, it may not be a very robust view, but I think it is a very practical view, that many of us have got accustomed to this P.A.Y.E. system and while no doubt you might devise one which in theory would be simpler and better, there is a great deal in having the devil you know. There is quite a lot in that, and I would like to say again, as we have said in this document, we have, from our many years' experience of this now, found the Inland Revenue always ready to consider any practical amendments that we put forward and the scheme is not now something imposed from above but something we have worked together on for quite a time now and there is a period of adjustment. I am certainly not going to say that every workman throughout the land understands P.A.Y.E., by no means, but I do think they are getting to understand it a little better and you would be surprised, as I have been, in conversation with groups of workmen who know sometimes better than the works' accountant what their income tax is going to be. I do not however for a moment say that the scheme is generally and completely understood, but it is getting worked in and there is a great danger if you start an entirely new scheme you will have a lot of opposition at the outset. This scheme has been run in.

* Not reproduced in these Minutes of Evidence.

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[Continued]

2332. It began in 1944 I think?—Yes. I do not want to speak about shipping but we had a scheme before that.

2333. Do you regard it as a serious administrative burden on the employer to have to operate the present system?—I think it is. It is not one of which we have asked to be relieved. It varies enormously with the size of the works or the size of the undertaking. There is no doubt that some small employers particularly find it pretty burdensome. The large employers of course get a section to deal with it, but we think in the nature of things it is impossible to give any definite figures, those we have are a guess. I will not put it higher than that. The guess varies of course according to whether you have a mechanised system or not, but we have reckoned the cost is somewhere in the neighbourhood of £5 millions or £6 millions a year on employers throughout the country. That is only a guess but it is a guess we think that is fair. It might be a million either way; we could not say. We have never asked to be reimbursed for that because we do not want to be regarded really as the paid agents of the Inland Revenue, but it is undoubtedly a burden and it is an intense irritation to the smaller employer. It may sound odd, I can fill up the forms for my own office, but I have great difficulty sometimes in dealing with domestic staff at home, and that is a simplified method.—Mr. Amblett: I think I should like to add there, as far as my own experience is concerned, I have not seen any representations from employers that we should endeavour to get them relieved from this work.—Mr. Young: I might say I think largely the reason for this has been that the Inland Revenue has co-operated with the employers in bringing this scheme in and the employers at an early stage appreciated the necessity for assisting the Inland Revenue in this matter. At all stages the difficult points have been ironed out. I do not think we want to pretend we like operating this. We should prefer there was nothing to do at all. It is not the cost; it is largely the difficulty from an administrative point of view. It is the fact that there is an additional piece of work to be performed which lengthens the period of working out the pay. There has been a tendency, recently, for employees to ask for payment early in the week, largely because some other person got paid earlier and, as things were short in the shops their wives wanted the money to get those things before somebody else got them. That factor, we hope, will disappear but the fact remains that, compared with pre-war, an additional operation has to be performed which cannot be done the week before and, in fact, the operation cannot be commenced until the wages have been calculated. This operation if performed by skilled junior staff or, at any rate, by staff used to the work, does tend to add perhaps half a day to the making up of the wages and is of considerable embarrassment to the employer.

2330. Have you any idea in terms of the labour involved in this work, what it amounts to, per employee?—There have been various estimates made and time studies have been taken. The lowest assessment that I know of personally, embracing the whole ascertainment of tax, amounts to approximately one minute per employee per week. The average will be much higher than that but there cannot be many cases where it is lower.—Sir Richard Sneed: We did get out figures, but again they are based on a comparatively small sample, showing a cost of about 4s. a year where you had a large firm with a mechanised system, and 10s. a year where you had not, per employee.

2331. Thank you. In paragraph 27 of your paper you begin to deal with various alternative schemes which you have had under consideration. I do not think I need ask you anything about that. In your view nothing has been brought to your attention by way of alternative schemes which seem to you as satisfactory as the present P.A.Y.E. system?—That is so.

2332. Then you deal with the special proposals, which have been made very public about the possibility of linking the income tax and the social security systems. I suppose one of the difficulties is that it depends what particular scheme you are going to consider from that point of view, because they take different forms?—Yes, we know of three main ones.

2333. If you are going to have a flat rate, it very much matters what the flat rate is going to be?—Yes, certainly, that of course is true.

2334. I pass to your criticisms of that kind of proposal. In paragraph 35 you put your point:

"While the adoption of a flat rate of tax might remove some of the discouraging effect of the present progressive rates of taxation, the imposition of tax at a high rate on all earnings would be likely to have serious repercussions."

If therefore one is to regard such a scheme as a practicable one, you must think in terms of a relatively low rate. Then you deal with one proposal which has thrown up a rate of 6s. 8d. in the £ as a flat rate, and I think your view is that it is quite impracticable?—Yes. The only low rate scheme was the one we referred to in paragraph 36 which gets down to 3s., but there the scheme does not apply to certain persons, single persons would not receive any weekly allowance. Our main objection to the scheme is, as you have said, this idea of taxing all earnings because naturally one is attracted by any scheme which throws out some hope of simplification. That is why we have examined the schemes, but the trouble with all of them is, I think, they ignore what one might call the flesh and blood aspect. It is all very well to say you take away with one hand and you give with the other, but I do not think the average man regards the schemes in that way at all. He will feel under a grievance (when I say average man, I mean average wage earner, man or woman) he regards the money he has earned as his own money and if it is taken away in taxation he regards himself as being taxed much more heavily than before. Then you hand him back some form of allowance or benefit. We certainly would not want that to be done through the employer. We do not want the employers to be a paying agency for what you might call national benefits, but once you start this theory, it seems to me, as we have said in paragraph 40, you divorce all idea of restrictions from the social services. You then get the idea that you have paid in something for taxation and the State, which in most people's minds has nothing to do with them, it is something separate, the State is providing these benefits and you take away all restriction contribution qualifications. It would be very difficult to resist putting up the benefits even though the Exchequer could not bear it, and it seems to me under this system while having a few attractive simplifications at the outset, it means that you are taking the brakes off. That is our objection to every scheme. The objections vary in strength according to the scheme and the objections have been adjusted as the result of public discussion, but we still object to them.

2335. I think you say in paragraph 40 that the question whether you should remove the right to benefit from the payment of contributions for social services involves a major question of principle.—Certainly.

2336. Your view is that it is a bad principle to allow it to be done?—Yes.

2337. Of course, as you say the 6s. 8d. flat rate, to which I was referring, is in the view of the proposer of such a scheme to be mitigated by these cash allowances which are to be paid out?—Yes.

2338. And in your view that would not psychologically make much difference?—No difference at all.

2339. Then you deal with further points and difficulties in paragraphs 37 and 38. At paragraph 41 you have another point, that is, it would be difficult under any such scheme to provide the machinery for dealing with small income tax allowances that are of importance to the workman in respect of his liability.—If you bring that in you are adding to the complications that the scheme was directed to get rid of.

2400. If you leave out any such allowances you would have a very difficult position in your view?—Yes, you would get grievances.

2401. In paragraph 46, you have something about employees who go abroad which I should be grateful if you would explain.—I will ask Mr. Honey to speak about this. It is primarily in the engineering and civil engineering industry.

2402. Let me get what is involved. Engineers and civil engineering people might have to go to very bad climates in the service of their firm, they remain perhaps up to two years and though remaining abroad they are liable to be taxed at British income tax rates.—Mr. Honey: Yes. They have to be paid highly to go to what would be an unattractive job and the fact that they are subject to

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[Continued]

British income tax means that the gross indacement has to be very big indeed. It is I understand a big difficulty in getting people to take on overseas contracts.

2403. I follow the difficulty. You are not suggesting there should be an amendment of the system of law which makes them liable to British income tax for what may be up to 24 months after going. You want a special concession for foreign conditions?—We thought that would be a simpler solution rather than a major amendment of the law.

2404. Would it not be administratively rather difficult to get a scheme out? People are going to various parts of the world on all sorts of kinds of jobs, some quite short. Something is to be allowed off by way of expenses because they are going to an unpleasant part of the world. I am only asking for your view. It sounds a difficult thing to press as a rule?—We do appreciate the difficulty but if the man stayed three or four years the position is different.

2405. Indeed, then he is outside the scope of the tax?—Mr. Young: I think we did tend to suggest that the Inland Revenue might consider the possibility that all earnings abroad should be treated as earnings abroad.—Mr. Amphlett: This is not only a question of keeping down the cost to the employer of sending his workers abroad, but it is a very important question in obtaining contracts for doing work abroad, which is a national matter, and I think that is the important angle. It is so important that it might be even worth while amending the law because of its effect on our export business especially as we are having to deliver more and more capital plant and practically all capital plant involves sending out workmen to do the erection.

2406. Chairman: Thank you. I think these are all the questions I wanted to ask. Now my colleagues will put some questions.

2407. Mr. Woodcock: Just one or two questions. You do not deal in this paper with any of the larger questions such as replacement cost. I suppose you are leaving that to the Federation of British Industries?—Sir Richard Sneed: That is right outside our scope.

2408. You deal, as you say, in paragraph 2 with the labour questions as you call them arising out of the relationship between employers and employees?—Yes.

2409. Your tables show how taxation has increased and how Government expenditure has increased and so on and you make it a complaint that there is so much taxation and so much Government expenditure. But if you assume the Government needs this expenditure, have you any suggestions as to how you would adjust those percentages you set out in paragraph 3?—I do not think so. We are merely setting out the facts here. All of us have our own private ideas of where economy could be effected, but I do not think we are prepared to say how we think the expenditure should be reduced or how the proportions should be reduced. We consider that there is a pretty heavy rate of taxation now and that in itself has a pretty serious deterrent effect on industry.

2410. You know that the Commission is supposed to make recommendations on the whole consistent with securing the same yield of taxation?—Yes.

2411. If we take that limitation upon us, that is, if we are to assume the rate of Government expenditure is something which cannot be reduced, then the question raised in your paper is a question of adjusting the percentages in paragraph 3. Would you increase the proportion of indirect taxation?—I am not prepared to answer that question at all. We are not prepared to make suggestions on reductions in Government expenditure or in regard to altering the proportions. I am sorry, but that is the position.

2412. Mr. Woodcock: You raised the point. I did not write the memorandum.

2413. Chairman: I suppose your Confederation has not considered that aspect of the matter and therefore you cannot speak for them?—No.

2414. Mr. Woodcock: There was a point you made in paragraph 45, about deductions from taxable income for outgoing expenses. You speak of an anomaly where manual workers receive certain allowances and other

workers do not. Are you asking for uniformity all round in these allowances?—We are never very sure about that. Sometimes when we suggest that to individual members, I know it happens in one of the industries with which I am connected, some of our people say, "We are better off with the local inspector". That is quite a common practice. On the question of office workers, it happens for example in the cotton and jute industries where there are no allowances for certain clerical work where overalls are used but there are allowances for manual workers who use overalls. I expect Mr. Woodcock knows a great deal more about this in practice than I do.

2415. I was wondering about it. I think your paragraph is based on a misapprehension. You say:

"It is felt that there should be a review of the position by the Inland Revenue with a view to establishing a uniform policy."

but the law is of course that you can only claim as an expense that which is wholly, necessarily and exclusively incurred. A clerical worker in incurring an expense of that kind has a claim anyhow, but are you suggesting there should be an automatic allowance for all workers?—No.

2416. Then you really do not want any alteration in the present position where they make claims for the actual expense incurred in earning a salary?—I think our suggestion here is that there are different practices in different parts of the country.

2417. Is that so?—We are told it is so.

2418. You know, that as far as manual workers are concerned, it is done mostly on negotiation with the trade unions. There is uniformity in that field, a smoothing out. They do not examine each individual case. If you are an engineer you claim the allowance given to engineers. You think that is not working uniformly in the country?—I think it is working on the whole well, but there are exceptions.

2419. You do not want an alteration in the law?—No.

2420. Miss Sutherland: One very small point on paragraph 19 of your memorandum. You say:

"Another effect of present taxation is to narrow the differentials between skilled and unskilled workers. This factor does not yet appear to have had any material effect in limiting the supply of persons willing to undertake the training necessary for skilled work."

That is your experience?—I think that is true, yes, that is generally true. You will get any amount of exceptions but it is one of those generalisations that taxation is preventing people from taking on more responsible work. It is one of those generalisations which is very attractive and which one knows in some cases is true, but I doubt whether at this stage at any rate it is generally true.

2421. Mrs. Anstey: May I ask one question on the questionnaire which you say you sent to your members. Perhaps I could have a little more information; was it a general question asking for an opinion as to the effect of taxation as a disincentive, or was it something much more detailed?—They were the questions put out by this more detailed?—They were the questions put out by Mr. Commission; I think I am right in saying that?—Mr. Honey: That is so. In so far as they related to the scope of the Confederation's work. Quite a number of those questions related to factors which do not fall within our province at all.

2422. In relation to disincentive, when talking about overtime and disincentive, I thought you said you had specifically got some evidence from your members that taxation was a disincentive?—Sir Richard Sneed: We put that question to them.

2423. It was just a general question?—Mr. Young: The question we put was:

"Can you give any practical examples of undesirable effects of high rates of direct taxation?"

2424. I wondered if you did get any actual evidence about cases or was it a general opinion?—Some industries about cases or was it a general experience, some said it was said that was their general experience but there were exceptions with young unmarried men. It is very difficult to prove anything on this but anybody with any experience of industry knows this heavy taxation does have some disincentive effect.

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[Continued]

2425. Mr. Crick: Perhaps the most important paragraph in your whole paper, from an information point of view, is No. 15, where you make this categorical assertion which has already been mentioned; that assertion relates to work people, by which I take it is meant wage earners. When you summarise your findings in paragraph 50, you say:

"The present high level of income tax results in a significant discouragement of effort."

Is that very general statement to be read as implying that you feel there is a disincentive effect in sectors other than the wage earning sector, for instance, in the technical or the managerial staff?—Sir Richard Sneed: There is not the slightest doubt about that I should say. There is a disincentive effect right through, but the higher the tax, there are limits to this, but the higher the tax the greater the disincentive effect.

2426. Would you say there is a strong disincentive effect at the surtax level?—Certainly, we are rather getting away from the people we represent. In industrial negotiations we have not got many at the surtax level, but I think we might stray a little from that and say certainly surtax has a deterrent effect on the higher executive.

2427. At the wage earning level it takes the well-known forms which you mention in your paper. What particular forms would you say it took at the level we are speaking about now?—Reluctance to take on extra work, reluctance to advance to higher responsibilities. A good deal depends on one's own domestic circumstances. The married man has probably a spur to go on even for comparatively little benefit, but I think in the case of others there is not anything like the spur.—Mr. Amphlett: May I add a word on that? I think when you are dealing with the effect on executives of high taxation, it is a mistake always to relate it to terms of work on the part of the higher executive. Work is only one part of our job. Perhaps the most important part of our job for the future of this country is the change in direction of our work and I think these high tax levels tend to deter a man from branching out into a new field of development and it is on new fields of development that the industrial strength of our country depends. I hope I have made a distinction between work and the type of effort he puts in.

2428. Would you say there is any obstruction imposed by tax factors upon transfers out of one group of occupations to another, for instance, from the wage earning level to the managerial level?—Sir Richard Sneed: The first stage is from the chargehand on the shop floor to foreman and I should think the level of taxation has an effect on that and would deter some men from accepting the foremanship job.

2429. Beyond that?—No, once a man has gone on to the staff, that is he has accepted a job as foreman, I doubt whether the present tax level would affect his accepting higher promotion unless he reaches a fairly high level in the executive.

2430. There is one question I should like to put; a difficult psychological question, but it has been touched on particularly in some remarks that Mr. Young made. I suppose the perfect tax system would have, among other qualities, the quality of simplicity, that is to say it would be very easy for a man to work out his own liability, and at the same time the quality of equity—a palpable paradox. I gather from what Mr. Young said that if he had to choose between the two qualities, recognising that maximum simplicity and maximum equity are together unattainable, then he would choose equity in preference to simplicity?—Mr. Amphlett: May I add to that one qualification, that the equity would have to be apparent to the worker. You have that limitation.

2431. Yes. Would you say from your experience of the psychology of the wage earner that would be his preference?—Yes, I think it would. As long as he understands he is being fairly treated he is not much worried about the complications the employers might be involved in or the income tax authorities.—Mr. Young: I would agree with that.

2432. Mr. Carrington: I want to follow up the answer to one of the questions put by Mr. Crick, that is in regard to the deterrent effect of surtax. Do I gather your evidence is to this effect, that whereas surtax does not deter

a man from accepting promotion within his own organisation or his own field of activity, it is known from experience, that it is a deterrent in branching out into a new field of activity. Is that a fair summary of that point?—Mr. Amphlett: As it was I who made that statement, I will reply. We are not giving formal evidence on this question. Sir Richard agreed to extend our representation by commenting on the point when it was raised. Subject to that, then you have correctly interpreted what I said.—Sir Richard Sneed: I would personally go much further, subject to the fact that we are not giving written evidence on this, we are only giving our experience. I think there is a deterrent effect from surtax whether within or without the same organisation. There is no doubt about the deterrent effect outside, but I do know cases in my own experience where first rate men have hesitated, and in two cases I know they refused to take on substantial extra work for that reason. At least, that is the reason they gave. I do not know what the real answer is. It is the same story again. You can never really tie this down, only get a general impression, but leaving aside surtax and coming back to income tax alone, it is certainly true in my experience that what you might call foremen or petty officers, men who might make good foremen or petty officers, I use the phrase because I am in shipping myself, have hesitated and quite often refused to take on these n.c.o.'s jobs because they feel they are as well off without it and they do not have the responsibility.

2433. In other words there is more than one motive involved?—Certainly.

2434. Just one point of detail in regard to what is stated in paragraph 46, this problem of the employee who is required to work abroad for a period. Have you in mind an allowance which compensates the man for the additional cost of living in some unpleasant place or which compensates him for the discomfort. In other words, are you seeking an allowance for some additional expenditure which he has to incur or for what you would regard as true remuneration, viz. compensation for effort and discomfort?—Mr. Young: I think the position is that the Confederation has felt it was its duty to point this difficulty out to the Commission and to suggest to the Commission that they should suggest some way out.

2435. The reason I ask the question is that I have come across the very same point in practice in my own work and I was wondering whether you could help towards a solution of the problem?—Unfortunately with most solutions in income tax which can be found to the immediate problem the Inland Revenue immediately find there will be nine cases where this solution can be used to give an allowance which is not justified.

2436. In other words you have not arrived at the stage of putting a concrete proposal forward to deal with this problem?—That is so.

2437. Sir Geoffrey Heyworth: In talking about the operation of P.A.Y.E. in paragraph 22 and again when considering some form of consolidation of social service payments with the income tax, paragraph 42, you come to this point, that it is undesirable in principle that the employer should have knowledge of the family circumstances of his employees. If that is to be accepted absolutely it seems to me that bars the way to a big field of possible simplification. I would just ask you this. A number of concerns have pension schemes. You cannot operate a pension scheme without some knowledge of the family circumstances of the people who are concerned. In those cases you get information about family circumstances?—Sir Richard Sneed: It depends I think a good deal on the pension scheme. The number of employees under pension schemes as opposed to the State scheme is a comparatively small percentage, though very large in certain industries including my own. It does not follow if you have a pension scheme that you have real information about the family circumstances. I know one that covers about 35,000 employees where there is no information at all; there is no widow's pension or children's allowances in that case.

2438. Where there is a widow's pension and children's allowances it does involve some knowledge?—Yes.

2439. And it has not prevented pension schemes of that sort operating or impaired good industrial relations?—That is so.—Mr. Amphlett: I think it is a fact that for income

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[Continued]

tax purposes you would have to have a more detailed knowledge of the person's circumstances.

2440. I am coming to that. The next point is that there have been family allowance schemes worked by individual industrial companies from time to time. I mention one in particular, Pilkingtons of St. Helens. They had a scheme which operated for many years and that involved a tremendous amount of disclosure. Presumably, since the scheme continued, the advantages of the scheme outweighed any interference with the lives of the people?—*Sir Richard Snedden*: This raises the whole question of family allowances which I think started as a scheme on the Continent, particularly in France. I am not sure that we are stating an official view but I think it is a general view, I look to Mr. Honey to stop me if I am wrong. I think the employers as a whole are against family allowances; I am not certain but I rather think the T.U.C. probably takes the same view because our view is a man ought to be paid for his work and not for his domestic circumstances.

2441. I was making the point that family allowance schemes had been operated in this country and it did involve disclosure of personal family details. You have mentioned that on the Continent these schemes exist. In Switzerland the whole of the family allowances are paid, as I understand, by the employer. All an employee does when a child is born, is to get a certificate and hand it into the pay office of the company which employs him and they automatically pay out the allowances. That is the simple system, yet I think probably you would agree industrial relations in Switzerland are of a high order?—*Mr. Amphlett*: May I comment on that. I suggest it is a mistake to assume that because a system works in Switzerland it is therefore desirable to operate it in this country and it is also a mistake to assume that because a particular firm is able to operate in this country a scheme of family allowances, it is suitable for general application in industry. The relationship between employer and work people varies enormously as between one firm and another.

2442. The only point I wish to make is this. I wondered if this generalisation that we must not consider these things because they interfere with the life of the people has in fact received detailed study, or whether it is a generalisation which happens to fit the idea "I do not think that that business is worth going into". It does seem to me, because of the instances I have given, that in certain circumstances when everybody agrees a thing is desirable (and that of course would mean the employee as well as the employer) disclosure can be accepted. One must not shut it out and say there is a sacrosanct principle that nobody should know anything about the life of anybody else and therefore we cannot alter it?—*Sir Richard Snedden*: We cannot say it is sacrosanct but it is a very strong view that is held. Not only in this matter but we have had many questions put to us by Government departments which would involve disclosure of family

circumstances and that is never received well, but there are exceptional cases.

2443. *Mr. Greenwood*: Only a small point. Mr. Carrington really raised the point I was going to. In the case of an engineer going abroad for a year or a year and a half to build a bridge or something like that, presumably all the cost of his living abroad would be paid for as an expense if you sent him out to do a job?—*Mr. Amphlett*: Normally he does have expenses as well as his salary, that is true.

2444. And I imagine he would not be out of pocket at that end anyway, or he should not be?—He should not be.

2445. But what does happen is, he still has to pay his taxation on his remuneration from the firm?—That is right.

2446. *Mr. Bullock*: Coming back to that same point again, I take it your complaint about the difficulty in regard to people who are working abroad is on the question of time rather than of merit. Assuming for the sake of argument that a man leaves Britain on the 5th April and he stays there until the following 5th April he gets away with it. He can leave Britain on the 7th April and come back within a few days of two years and he gets no relief at all. That is your complaint?—*Mr. Young*: Exactly.

2447. It is on time rather than on merit?—We think it is merit as well.

2448. My other question concerns the point that was raised by Mr. Amphlett on the question of allowance for wear and tear. What you are really saying is that in the same industry, take one or two that I know such as quarries or bricks, in one part of England there can be allowances for wear and tear on boots and clothing and in another part of England they may be half and there is a sense of inequity?—*Mr. Amphlett*: Yes, that is one point but I do not want the Commission to be misled into assuming that is the only one. Reference has been made to the authorities allowing the cost of overalls as a charge against income when overalls are worn by work people in, say, a cotton mill or jute mill but they have refused to allow the same cost for the same type of overall to a man on the staff who also has to work in the mill. That is the other point, in other words, different categories of employees are treated in different ways.

2449. I think you will agree that the human factor comes into this, just as you find differences in other classes of individuals so you will find men or just or generous people in the employment of the Island Revenue?—*Sir Richard Snedden*: We make no comment on that.

Chairman: The Commission are very grateful to you and your colleagues both for your helpful paper and your helpful evidence. Is there anything arising out of the questions we have put to you that you would like to enlarge upon before we say goodbye?—I do not think so.

Chairman: Thank you very much.

The witnesses withdrew.

Mr. J. H. KEELING and Mr. G. P. S. MACPHERSON, O.B.E., accompanied by Mr. F. B. PROCTOR and Mr. J. W. MARGETT, on behalf of the Issuing Houses Association; called and examined.

MEMORANDUM SUBMITTED BY THE ISSUING HOUSES ASSOCIATION

INTRODUCTION

1. This memorandum makes submissions under Section A of the "Heads of Evidence" notified by the Commission. In preparing these submissions, the Issuing Houses Association has endeavoured to confine its remarks to those principles and practices in the present system of taxation to which the critical attention of its members is constantly being drawn in the day-to-day practice of their business. The members of the Association feel, from long experience in the raising of finance for industry that these particular principles and practices are proving detrimental to the economic welfare of the nation.

2. In general, evidence is provided by experience of—

(a) the losses obliging businesses to raise fresh capital,

(b) the frequency with which established and profitable businesses are obliged to turn to the Issuing Houses for finance,

(c) the difficulties experienced by the Issuing Houses in satisfying the requirements of their clients with due regard to the principles of sound finance and the maintenance of a proper balance of capital structure.

3. The submissions made all relate to Heading 3 of Section A of the "Heads of Evidence", namely, "Is the present treatment of companies for taxation purposes satisfactory, or should it be altered?"

4. If the Commission should so request, the Issuing Houses Association will be pleased to nominate members to present oral evidence on the submissions made in this memorandum and to provide specific cases.

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[Continued]

PROFITS TAX

5. Profits Tax is a heavy burden imposed specifically upon industry which adds markedly to the difficulties of providing capital requirements on a sound basis.

6. This tax varies in its incidence on individual companies according to their capital structure and tends to influence companies to obtain by the issue of loan capital rather than of share capital the finance required to provide for development and to meet higher prices. It introduces a distorting and what would otherwise be an irrelevant element into deliberations on the form of capitalisation best suited to a company's future stability and development.

7. Under existing Profits Tax regulations interest on Debentures, Notes and Loans is allowed as a charge before arriving at taxable profits, but Preference dividends are not. Thus with Profits Tax at the current rates, the cost of a Preference dividend of 5 per cent. is raised by 55 per cent. to 7.75 per cent. and of a 6 per cent. dividend to 9.333 per cent. This has two effects:

(a) Companies are influenced to seek new capital by way of Notes, Unsecured Loans and Debentures rather than by the issue of Preference shares, whereas the latter may be the more prudent method of finance.

(b) Companies which in the past have raised finance by the often more prudent method of issuing Preference capital rather than Loan capital are seriously penalised as the effective cost of dividends on such Preference capital is far higher than was contemplated under the terms of issue.

Smaller companies, whose Preference capital often carries high dividend rates, tend to suffer more than the larger companies.

8. Profits Tax is also clearly a deterrent to the issue of Ordinary capital as opposed to the raising of Loan capital when, as now, the combined rate of Profits Tax and Income Tax on a company's profits may be as much as 13s. 3d. in the pound. There are comparatively few companies which are unimpaired by the difficulty of maintaining a rate of dividend on increased capital in addition to making sufficient reserves for replacing fixed assets and stocks when so little is left out of each £1 profit.

9. The discriminatory and inequitable effect of Profits Tax, where Preference dividends are not allowed as a charge, is clearly shown in the following example.

If there were no Profits Tax, a company with equal amounts of 5 per cent. Preference and Ordinary Capital and earning just enough profit to pay 5 per cent. on the Ordinary Capital could divide each £1 of profit as follows:—

	s.	d.	
Income Tax ...	9	6	
Net Preference dividend.	5	3	(i.e. 10s. less income tax at 9s. 6d.).
Net Ordinary dividend.	5	3	(i.e. 10s. less income tax at 9s. 6d.).
	20	0	

With Profits Tax at 50 per cent. the corresponding figures are as follows:—

	s.	d.	
Income Tax and Profits Tax.	13	3	
Net Preference dividend.	5	3	(i.e. less income tax at 9s. 6d.).
Net Ordinary dividend.	1	6	(i.e. less income tax at 9s. 6d.).
	20	0	

i.e. the effect of Profits Tax on the Preference dividend is to cut the Ordinary dividend to less than a third of what it would otherwise be.

10. In practice, in their endeavour to maintain net profits companies will tend to offset the incidence of Profits Tax by raising prices with a consequent inflationary effect.

11. It is generally admitted that it is often sounder to obtain fresh capital for development by the issue of Ordinary shares rather than Debentures or Preference

shares. The issue of Ordinary shares provides a cushion against the losses which trade fluctuations may bring and borrowing power is available against the time when finance must be obtained and Ordinary shares cannot be issued. The influence of Profits Tax therefore tends to the distortion of the capital structure of a company and this is harmful and not in accordance with the soundest financial principles. We therefore recommend:

Submission 1

That Profits Tax as at present levied should be replaced by other taxation less conducive to unsmooth capitalisation; and that if Profits Tax is not so replaced, the fixed element in dividend distributions on Preference Shares should be allowed as a charge against profits when calculating the amount of Profits Tax or any other substituted tax payable.

TAXATION OF WORKING CAPITAL

12. The general proposition on which our submissions with regard to the taxation of working capital are based is that a continuing business cannot be said to have made a true economic profit unless its real capital has been maintained intact, and in particular that such business has made a true economic loss to the extent that any profit in terms of money is insufficient to cover any increased money cost over the same period involved in holding its normal physical volume of stock-in-trade.

13. Accounting must necessarily be done in terms of money as the common denominator of the relative value of goods, and while the value of money in terms of goods is relatively stable accounting profits will fairly represent true economic profits. But accounting profits, based as they are upon historical cost in money, do not take into consideration the change of value of that common denominator relative to the general value of goods; if the value of money depreciates fairly rapidly, as it has done during the past 12 years in this country, a business may show large accounting profits but be quite unable to replace its initial stock of goods even though no profits have been distributed to the owners. During these last 12 years the Second World War and its aftermath together with the devaluations which have occurred in our currency have introduced special features into the problem which, however, have not been recognised by those responsible for the incidence of taxation.

14. The true position is easily seen if a 100 per cent. tax on profits is assumed to be universal. The present system of stock-in-trade valuation for taxation purposes would then, in a period of steadily rising prices, result in the condemnation every year not only of all profits on transactions, but also of any excess of the valuation of the closing stock over that of the opening stock. If all prices doubled during such a period businesses would lose half the working capital in the form of stock-in-trade with which they began: if the process were continued, business would soon cease to function, for what purported to be no more than a tax on profits would in fact be away almost the entire working capital of the country's business community.

15. While the value of money remained relatively stable or depreciated only very gradually and the rate of taxation was low, the effect of taxing company profits without reference to the value of money were inconceivable; with company taxation at its present levels and the inflation of prices, we submit that in the interests of the economic wellbeing of the country the existing situation cannot be allowed to continue. It has already caused serious difficulties in the financing of industry and trade during the last 12 years of rising prices.

16. The true nature of "inventory profits" is generally recognised by the managements of companies of any size and importance and it is recognised as sound finance to create inventory reserves against the additional costs of holding stock-in-trade. We submit that this practice should now be given formal recognition in the taxation laws of the country by allowing such inventory reserves as a charge for Income Tax purposes.

17. Though the working out of the system in practice is bound to present some difficulties, rather than that some measure of relief should not be given it would be preferable in the economic interests of the nation that the raising

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of Inventory Reserves should be permitted on some approximate but easily calculated basis. We therefore submit:

Submission II

That in the calculation of profits according to the rules of Schedule D, Cases I and II, the option should be given to businesses of raising an Inventory Reserve by a charge against profits before tax.

TAXATION OF FIXED CAPITAL

18. The maintenance intact of the fixed real capital of a business such as that embodied in buildings and plant and machinery requires that sufficient funds should be set aside out of profits over the life of such fixed capital to replace it when it wears out or becomes obsolete.

19. In a period of stable price levels, or over a period in which the price level fluctuates above and below a stable mean, this requirement is satisfied if the money cost of each fixed asset is set aside as a charge against profits over its effective working life.

20. Over a long period in which there is a movement of prices in one direction only, however, the aggregation of allowances for depreciation based only on the original costs of fixed assets fails to provide funds for the replacement of the asset. When taxation is as high as it is now, taxed profits are only too frequently insufficient to make good the deficiency and recourse must be had to outside finance.

21. Accepted accountancy practice applies the historical cost of an asset over its working life; it does not take into consideration altered values in terms of goods of the unit of money in which the accounting is made. Where the money unit of account depreciates in terms of goods, allowances beyond depreciation charges based upon the historical cost are needed to replace assets. If taxes are levied on an accounting profit arrived at before making

such allowances they will be taxes which will often reduce the real capital employed.

22. The dangers in this respect are greatly intensified when the level of taxation on companies is as great as it is at present, and when taxation at such levels has been in force for more than a decade of rising prices. The practical results are evidenced by the difficulties experienced by companies, big and small, all over the country in financing their businesses from internal sources, despite what appear to be record gross profit levels.

23. Certain European countries which have experienced an even more rapid decline in the value of money than in the United Kingdom have recognised the dangerous consequences of basing taxation on profits arrived at by accepted accounting principles on the historical cost basis in terms of depreciated units of currency and their taxation codes now establish in various ways provisions for charges against such profits which have helped to alleviate the position.

24. The conditions resulting from the depreciation in the value of the pound and the extremely high rate of taxation demand that account should be taken of the replacement cost of fixed assets in determining the amount of depreciation to be allowed for taxation purposes. Provisions giving as close an approximation as possible to the required result should be introduced into the taxation system without delay. Even a partial or approximate safeguard against taxation of the real capital of industry in times of prolonged inflation is greatly preferable to no safeguard at all. A method of adjustment should not be turned down upon the grounds that it fails to achieve perfect results in every case. We therefore make the following submission:

Submission III

That account should be taken of replacement cost in determining the amount of depreciation allowances for taxation purposes.

6.6.1951.

SUPPLEMENTARY MEMORANDUM SUBMITTED BY THE ISSUING HOUSES ASSOCIATION

SPECIFIC CASES IN SUPPORT OF MEMORANDUM DATED JUNE 6th, 1951

The following specific cases are submitted to illustrate the arguments submitted by the Issuing Houses Association in their Memorandum dated June 6th, 1951, to the Royal Commission on the Taxation of Profits and Income:—

1. Case "A" relates to the Associated British Picture Corporation Ltd., a public company, and is in support of Submission 1 of the Association's memorandum in regard to Profits Tax.

2. Case "B" relates to Johnson, Matthey & Co. Ltd., a public company, and is in support of Submission 2 of the Association's memorandum dealing with the Taxation of Working Capital.

3. Case "C" relates to a private company, "X", which desires to remain anonymous, and is in support of Submissions 2 and 3 of the Association's memorandum dealing with the Taxation of Working Capital and the Taxation of Fixed Capital.

14.5.1952.

CASE A

ASSOCIATED BRITISH PICTURE CORPORATION LTD.

1. In February, 1946, the above Corporation had outstanding £2,955,883 4½ per cent. First Mortgage Debenture Stock. In a letter to the members dated 15th February, 1946, it was stated:—

"Your Directors have had under consideration for some time the question as to what steps could be taken to strengthen the financial structure of the Associated British Picture Corporation Group of Companies by the reduction of the very large amount of loan capital and the redemption of the Preference Capital and Income Certificates of the Corporation's subsidiary company, Union Cinemas Limited.

It is accordingly proposed that the Group should exercise at the earliest opportunity its right to redeem

the following prior charges which it has the option to redeem on advantageous terms:—

4½ PER CENT FIRST MORTGAGE DEBENTURE STOCK—	£
Associated British Picture Corporation Ltd.—£2,955,883 Stock Redeemable at 103 per cent.	3,044,560
REDEEMABLE 6 PER CENT £1 PREFERENCE SHARES—	
Union Cinemas Limited—	
639,596 First Preference Shares (excluding Group Holdings) redeemable at 22s. per share	£ 692,556
619,099 Second Preference Shares (excluding Group Holdings) redeemable at 22s. per share	681,000
	1,373,565
5 PER CENT REDEEMABLE INCOME CERTIFICATES—	
Union Cinemas Limited—£174,493 Certificates (excluding Group Holdings) redeemable at 102 per cent.	177,983
	£4,596,108"

2. The above prior charges were redeemed out of the proceeds of an issue of 4½ per cent. Pre-Preference shares of £1 each.

3. In their letter the Directors stated:—

"The Directors are satisfied that, as a result of the issue, the finances of the Group will be placed on a much firmer basis and are of the opinion that the proposals now put forward are in the interests of both classes of Stockholders."

4. At the time the above transaction was carried through the rate of Profits Tax (then National Defence Contribution) was only 5 per cent. and was payable at the same rate on distributed and undistributed profits.

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5. Since 1st January, 1947, however, the rate of Profits tax on distributed profits has increased very substantially and the effective gross cost of the dividend on the 4½ per cent. Pre-Preference shares based on the rate of 17½ per cent. net (equivalent to 33½ per cent. Gross) for Profits Tax on distributed Profits proposed in the Finance Bill, 1952, would be 6 per cent.

6. Thus the Corporation has been heavily penalised as regards Profits tax as the result of the action taken in 1946, which was taken solely for the purpose of strengthening the Corporation's financial position.

7. The following remark was included in the Chairman's statement accompanying the Accounts of the Corporation for the year to 31st March, 1951:—

"I would point out that if the Group's large Pre-Preference and Preference Capital took the form of Debentures, these additional charges would not arise. The present anomalous position in which interest on borrowed money is allowed as a charge for profits tax whereas fixed preference dividends are treated as distributions, must tend to influence the financing of businesses on fundamentally unsound lines by encouraging the use of borrowed money instead of fixed preference capital."

CASE B

JOHNSON MATTHEY & COMPANY LIMITED

1. The business of the Company is principally that of refiners of gold, silver and platinum; it also manufactures articles from these metals.

2. A comparison of the net assets of the Company at 31st March, 1946, and at 31st March, 1951, is as follows:—

	31st March	
	1946	1951
Fixed Assets	£ 570,220	£ 1,680,208
Subsidiary Companies:		
Shares	174,087	180,544
Indebtedness	364,346	1,075,219
Trade Investments	17,672	74,477
Stock	1,216,310	3,025,794
Debtors and Bills Receivable	644,691	2,091,951
Cash	143,024	349,759
Defect:	3,132,350	8,408,952
Liabilities and Provisions	511,752	1,805,011
Net Assets before deducting borrowed money	£2,620,598	£5,603,941
Representing:—	£	£
Shareholders Funds:		
Capital	760,000	760,346
Reserves	770,447	2,690,223
Reserve for future Tax	145,000	540,000
	1,675,447	3,790,569
Borrowed Money	944,751	2,813,372
	£2,620,598	£5,603,941

Since the date of the Balance Sheet the Company has made an issue of Ordinary shares to raise approximately £2,100,000 in order to improve the liquid position and to finance a programme of modernisation and development.

3. It will be noted that in the period of five years ended on 31st March, 1951, the book values of the net assets employed have increased by approximately £4,080,000 of which £1,840,000 represents the increase in the book value of the Stock.

4. The Company's officials have estimated that of the £1,840,000 increase in the book value of stocks an amount in excess of £1,350,000 represents the amount attributable to increased prices. Assuming an average rate of tax of 10s. in £ taxation of approximately £675,000 has been

paid on this inflationary increase and this sum is included in the amounts borrowed by the Company at 31st March, 1951.

5. The following are extracts from information published by the Company—

26th July, 1950—Chairman's Statement on Accounts to 31st March, 1950

"Taxation Impact"

If you refer to the consolidated profit and loss account, you will note that it has been thought well in this particular year to differentiate between the £615,999 trading profit of the parent company, and the amount of £813,734 arising out of the increased values of precious metal stocks of which £689,849 is solely on account of the increased prices of gold and silver directly due to the devaluation of sterling."

"It is difficult to understand what justification can be found for treating this £689,849 as well as the appreciation in value of metals of the platinum group as a taxable profit."

"The weights of these working stocks of precious metals must be preserved as long as the scale of our operations is maintained. The greater amount of sterling for which the same weights could be sold, as a consequence of sterling having diminished in buying-power, puts no cash in the till of the Company. To tax increased value of working stocks of precious metals, on this score, is the exact equivalent of taxing the increase in value (the difference between present cost of replacement and the original cost) of every bit of plant and machinery in every factory in the country."

"A Policy of Abstinence"

"If your company were not financially strong—and the fact that it is strong is due to its having abstained from a full distribution of profits in the past—whence could it derive the cash with which to pay tax on the increase in sterling value of its working stocks?"

"Only by selling a large part of such stocks, reducing the scale of its operations, parting with many of its employees, rendering itself unable to make the same contributions to inland revenue as in the past and destroying its powers of continuing and increasing the great dollar-earning capacity to which so much thought and effort has been applied during recent years."

14th July, 1951—Circular letter to Ordinary Shareholders in connection with issue of Ordinary Shares to raise approximately £2,100,000 and increasing borrowing powers

"The Directors have decided that further capital is now required to finance the Company's present programme of modernisation and development and also to improve the liquid position of the Company which has necessarily been affected by the high cost of maintaining adequate stocks of gold and silver, metals of the platinum group, and base metals."

"The taxation liabilities of the Company coupled with the increased cost of financing stocks of precious metals, base metals and other stores, have reduced the margin between the current liabilities and current assets of the Company. In this connection your attention is drawn to the statement by the Chairman accompanying the Report of the Directors for the year ended 31st March, 1950, in which he stressed the particularly heavy incidence of taxation on the Company which is taxed not only on its trading profits but also on the paper profits representing the consistently increasing value of its working stocks of precious metals."

CASE C

X. COMPANY LIMITED

1. The business of the Company is the purchase of sheep and cattle in Australia and New Zealand and the sale of the constituent parts, viz. Wool, Meat, Skins and Hides, Pelts, Tallow, Casings, etc.

2. The period under review is the three years to 31st August, 1951.

3. The volume of business varied very little in each of the three years, it being slightly lower in 1951.

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4. The stock held at each Balance Sheet date comprises livestock products, i.e. Wool, Meat, Skins and Hides, Pelts, Tallow, Casings, etc. (see 1 above). The amounts were remarkably constant as at 31st August, 1948, 1949 and 1950, but at 31st August, 1951, owing to a dock strike, the quantities in stock were substantially higher.

5. The quantities of works stores (comprising in the main Stockinette and Hessian) increased by around 15 per cent. over the period under review. The stocks of stores were purposely increased to avoid breakdown of operations owing to difficulties in obtaining stores and delivering them to the works.

6. The following Statements are attached:—

Statement I

Summary of the Profit and Loss Accounts for the three years to 31st August, 1951:

- (a) before redrafting,
(b) after redrafting.

Statement II

Summary of the Balance Sheets of the Company at 31st August in each of the years from 1948 to 1951:

- (a) before redrafting,
(b) after redrafting.

Statement III

Reconciliation of Fixed Assets.

7. It will be noted from Statement I that no distributions have been made to the shareholders, the whole of the profits shown by the Profit and Loss Accounts having been retained in the business. In the two years to 31st August, 1950, these profits totalled £1,294,000 before Depreciation and Taxation, out of which £301,000 was provided for Depreciation and £486,000 for Taxation, leaving £507,000 to augment the capital resources of the business.

8. In spite of this, Statement II shows that over the two years to 31st August, 1950, the Company has had to increase its borrowings by no less than £1,194,000 from £2,029,000 at 31st August, 1948, to £3,223,000 at 31st August, 1950.

9. The above position arises in the main because substantially the same volume of stock has been valued at progressively higher prices each year and taxation has been paid on the amounts by which the valuation of such stocks has been increased.

10. In 1951, owing to a dock strike, the Company was unable to ship large quantities of its products before 31st August and had a substantially increased quantity of stock at 31st August, 1951.

11. The Company's Accounts have been redrafted on the basis of the profit or loss after making appropriate provision for maintaining the physical capital intact. The revised Profit and Loss Accounts and Balance Sheets are set out in Statements I (b) and II (b) and the basis adopted in redrafting these Accounts is shown in the notes on Statement I. No adjustment has been made to creditors in respect of taxation at present provided for but which, on the basis of losses shown, would not have been exigible.

12. It will be seen from the above statements that far from having made a profit over the three years under review, the Company would, after making provision on the above basis to preserve its physical capital intact in so far as it is represented by Fixed Assets and Stocks, have incurred a loss estimated at some £2,250,000. This has operated to reduce the physical capital of the business and this capital has been further depleted by taxation levied on the profits shown by the Accounts.

13. Had it not been for the fact that the Company was able to obtain additional finance from its Parent Company, the hold-up in deliveries at 31st August, 1951, might well have resulted in the financial collapse of the business. Although large profits were shown by the Accounts for the two years ended 31st August, 1950, the whole of which were retained in the business, the Company had to borrow increasingly large sums in order to maintain the same volume of business in 1951 as in 1949.

It is clear that although the Company's accounts have shown that profits have been earned in terms of money, it has in fact incurred a loss in terms of its physical capital. In such circumstances it is contended that no taxation should have been payable since such taxation has been met only by further depleting the physical capital of the business.

Statement I

X COMPANY LIMITED

SUMMARY OF PROFIT AND LOSS ACCOUNTS—3 YEARS TO 31ST AUGUST, 1951

	(a) Before redrafting			(b) After redrafting		
	Years to 31st August			Years to 31st August		
	1949	1950	1951	1949	1950	1951
	(expressed in £1,000)			(expressed in £1,000)		
	£	£	£	£	£	£
Profit before Depreciation and Taxation	364	930	284	364	930	284
Deduct:						
Depreciation—						
(a) Based on historical cost (corresponding approximately to taxation allowances) ...	139	162	148	139	162	148
(b) Additional provision to provide for replacement cost	—	—	—	278	324	296
Stock adjustment	—	—	—	219	774	924
Net Profit or Loss	225	768	432	272	330	1,632
Deduct: Taxation	125	361	—	125	361	—
Net Profit or Loss for year	100	407	432	397	691	1,632
Retained Profits or Losses brought forward ...	647	747	1,154	647	250	441
Retained Profits or Losses carried forward ...	747	1,154	722	250	441	2,093

Notes.

(1) The replacement cost of the Fixed Assets is estimated at around £7,000,000 compared with the book value of £3,128,000. For present purposes it is assumed that the Depreciation provision should be increased by at least 200 per cent. to provide funds for the replacement of the Fixed Assets.

(2) The stocks of livestock products in Australia and New Zealand have been revalued at each Balance Sheet date subsequent to 31st August, 1948, at the stock value as at 31st August, 1948, in respect of quantities up to those held in stock at that date, and in respect of increased stocks, at the cost in the years when the increase first arose. As regards stores, it has been assumed that half of the increased value in years subsequent to 1948 is attributable to increased prices and half to increased quantities. It is thought that in fact more than half would be attributable to increased prices.

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[Continued]

Statement II

X COMPANY LIMITED

SUMMARY OF BALANCE SHEETS—4 YEARS TO 31ST AUGUST, 1951

	(a) Before redrafting				(b) After redrafting			
	31st August				31st August			
	1948	1949	1950	1951	1948	1949	1950	1951
	(expressed in £1,000)				(expressed in £1,000)			
Stock—	£	£	£	£	£	£	£	£
As valued before redrafting	2,130	2,722	3,362	5,304	—	—	—	—
At stock value at 31st March, 1948, or cost in subsequent years where stock in excess of 1948 level	—	—	—	—	2,130	2,503	2,369	3,367
Debtors less Creditors	91	251	168	339	91	251	168	339
Fixed Assets less Depreciation	1,387	1,695	1,933	2,128	1,387	1,695	1,933	2,128
					3,426	3,947	4,134	5,154
Deduct: Provision for Replacement of Fixed Assets	—	—	—	—	—	278	602	898
	£ 3,426	4,166	5,127	7,771	3,426	3,669	3,532	4,956
FINANCED AS FOLLOWS:								
Share Capital	750	750	750	750	750	750	750	750
Retained Profits	647	747	1,154	722	647	250	441	2,093
	1,397	1,497	1,904	1,472	1,397	1,000	309	1,343
NET BORROWING:								
From Parent Company	3,105	3,157	3,602	5,245	3,105	3,157	3,602	5,245
From Banks	9	61	15	1,483	9	61	15	1,483
Less: Cash and Marketable Securities	1,085	549	394	429	1,085	549	394	429
	2,029	2,669	3,223	6,299	2,029	2,669	3,223	6,299
	£ 3,426	4,166	5,127	7,771	3,426	3,669	3,532	4,956

Statement III

X COMPANY LIMITED
RECONCILIATION OF FIXED ASSETS

	Years to 31st August		
	1949	1950	1951
	(expressed in £1,000)		
Balance at beginning of year	£ 1,387	£ 1,695	£ 1,933
ADDITIONS:			
(a) Replacements of existing works	342	366	310
(b) New Works	105	34	33
	1,834	2,095	2,276
Less: Depreciation	139	162	148
Balance at end of year	£ 1,695	£ 1,933	£ 2,128

The replacement cost of the above Fixed Assets is estimated at around £7,000,000.

EXAMINATION OF WITNESSES

2450. *Chairman:* Mr. Macpherson and Mr. Keeling, we are grateful to you for the two memoranda you have sent us and for coming here today. We have studied what you have sent in and I have just one or two questions. Would you mind telling me first of all, what does the Issuing Houses Association exactly represent?—*Mr. Keeling:* We represent all, I think I may say, of the issuing houses in the City of London and the one or two in the provinces and members of our Association have in each of the past two years been responsible for more than £100 millions of issues of capital. I would like to say any committee is composed not of experts or economists. We

are only business men who have had long experience in the issuing business and it is really in that capacity we have come rather than on any technical grounds. Mr. Macpherson has been the Chairman of my sub-committee which has been studying this matter and is much better qualified than I to answer any questions.

2451. We want to get all we can from you. The issuing house is concerned in the issue of capital to the public?—*Yes, that is right.*

2452. May I go through your memoranda and ask one or two questions to clear my mind. First of all, you deal

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[Continued]

with the subject of profits tax. Am I right, your main criticism of it is that it has a distorting effect on the arrangement of the new capital which is concerned in the issue?—Mr. Macpherson: That is right.

2453. The distortion being due, I think from what you say, to a distinction which the present system of tax draws between interest on debentures or notes or loans being deductible against profits for the purpose of the tax whereas the dividends on preference capital are not?—And ordinary capital.

2454. And ordinary capital, yes. You have given us one case where the distinction on that line has operated rather to thwart the obvious expectations of people who arranged a large preference issue, that is the Associated British Picture Corporation, the first case in your second document. But have you come across a number of practical cases where, when an issue of capital to the public is being made, the natural thing has been diverted by this consideration?—I think it is fair to say that the incidence of profits tax and the fact that it is unpredictable from year to year in rate is always an important, and sometimes an overriding factor in calculating an issue. May I put it this way. Take a smaller company whose shares can be issued at 10 per cent. to the public; that will cost the company under the present rate of profits tax nearly 15 per cent. Perhaps they can issue a debenture on a 5½ or 6 per cent. basis. There must in certain circumstances be a tendency to be attracted towards loan capital rather than what we might think fundamentally the sounder method of ordinary share capitalisation.

2455. I follow that, but what inherently is your objection to the use of loan capital? Is it the rigidity it tends to lead to the capital structure?—Yes, Sir, and also that when you have ordinary share capital some of that can be lost and the company can just carry on under the same amplex. If you have loan capital and suffer losses the whole control of the business may have to be changed.

2456. If you cannot maintain your interest in a bad year you may find a paviour put in?—Yes, in such times as the textile companies have had in the last few months, the existence of loan capital rather than ordinary share capital may be very dangerous for the existence of the company.—Mr. Keeling: It has always been the habit of issuing houses to advise companies to issue preference shares keeping the debenture stock up their sleeves for difficult times. In the last few years everybody has shown good profits but where companies have elected to put out debenture stock they can, when they come on difficult times, find they have mortgaged their future because most debenture stocks are secured upon their assets.

2457. If a company falls on bad times it has not the margin of power to issue further capital that will attract anybody. It has issued its prior charges in the form of debentures?—But it is very attractive to issue a debenture stock which you can issue at 5 per cent. as compared with issuing ordinary shares when the cost with profits tax even for larger companies may be nearly 15 per cent.

2458. You have actually come across cases, have you, where against what would seem to be the natural arrangement of the issue, the capital has been raised in the form of debentures, notes or loans?—I have, many cases. In fact, I hardly remember an issue where this point has not come up for consideration. The boards of companies are responsible for the final decision. The issuing houses point out the pros and cons. If one can avoid a debenture issue from the point of view of sound finance I am sure it is right; but it is very difficult to prove it on actual figures with taxation as it is.

2459. If you allow a preference dividend against profits for the purposes of tax, you will throw an even heavier burden on the ordinary shareholder unless you reduce the tax?—I think that comes to the fundamental point, the taxation which industrial companies have to bear. It would seem to me to be illogical that a company which happens to have raised its capital in the past in preference shares has to bear a heavier burden than a company which has persistently issued debenture stock. But if the whole burden falls on the ordinary share capital one of the things we fear is that attracting capital over a period of ten or twenty years is going to become increasingly difficult.

2460. I see you say in paragraph 10:

"In practice, in their endeavour to maintain net profits companies will tend to offset the incidence of profits tax by raising prices with a consequent inflationary effect."

Is that drawn from your experience or is it what you think is a reasonable deduction?—Mr. Macpherson: It was represented to the sub-committee by one of the members of the committee that that was so and it was thought it should be included in the evidence.

2461. I am trying to separate off what you have actually come across in your experience from what you think is a reasonable argument.—It did not come into my experience but it was represented as coming within the experience of a member of the committee. Mr. Keeling: I think one can say in general practice any company must look to the net profit they are going to make and if it is possible on their turnover to make a profit that is sufficient to look after this point, I should have thought human nature and certainly industrial companies with which I am concerned would take that into consideration.

2462. Then we get to your proposal in paragraphs 12 to 17 about the taxation of working capital. You have given us an interesting example in your other document, that is the second case, the company, Johnson, Matthey & Co. Ltd., of this problem of inventory reserves. I wish you would make it clear to me what exactly you have got in mind in this proposal to allow inventory reserves? Am they to be for all purposes a charge against the profits of the year in which you make them?—Mr. Macpherson: Do you mean for taxation and other purposes?

2463. Yes, that is what I meant first.—I think that was certainly our belief; rather following the experience in the U.S.A.

2464. You would then expect a company, if this was to be the acceptable system for the purpose of assessing taxation, to carry out the same system in regard to the treatment of its profits in regard to its accounts for its shareholders?—Yes.

2465. Would you regard it as a way of dealing with profits that it has made or a charge against the profits before they are made?—As a charge before they were made, and this should be clear in the accounts.

2466. A charge against the profits of the year?—Yes.

2467. What then is it to be a reserve against? You transfer the amount of money you want from the profits of the year to what you call an inventory reserve. What is it kept for, what do you do with it for the following years?—As prices vary it would be employed; that is to say, where prices of end stock as compared with opening stock fell there would be a withdrawal from that reserve according to the practice current, so I understand it, in the U.S.A. This is rather a technical side of accounting procedure.—Mr. Keeling: Might I add something. In the wool textile industry, inventory reserves have been created by almost all companies. With the very quick rise in the price of 64 B Tops after devaluation from under 100 pence per lb. to 345 pence, it was impossible not to make profits on the rise in the value of stock apart from normal trading, and this led companies to set up one of these reserves against a subsequent fall in the value of the stock or losses resulting from such a fall. Take the case of a Company which has set up a Reserve of £500,000. This comes out of taxed profits and really represents a million, but it is all the same in the long run from the point of view of the Income Tax, as the tax has to be paid eventually. If the company subsequently makes a loss, then the taxed reserve comes into its own but some years later. It would be much clearer from the point of view of studying accounts and easier from the point of view of issuing houses if the reserve against the stock could be made before the incidence of taxation. The tax is paid sooner or later; it is a question when.

2468. Is it a reserve against the fact that having bought stock in one year at what seemed very high prices, you may in later years find you cannot realise it at that price?—In the wool textile industry we went round the cycle. The price of 64 B Tops was 125 pence per lb.; it went down below 100, rose to 345 and is now about 125. Quite clearly when you are carrying on an active business and an enormous fall like that takes place, there are a number

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of ways in which you can lose money. You can lose it if you are in an over-bought position, or you can lose it if your customers cannot stand up to their commitments. Worse still there are countries, such as Australia and New Zealand where they have brought in laws which prevent their nationals taking up the goods which they have bought. This shows the need for a stock reserve, though as far as possible companies charge such losses against current trading profits if these permit it, thus keeping their taxed reserve intact.

2469. I do not want to harass any of you gentlemen with questions, I want just to clear my mind. Supposing in the following year then, after you had bought stock at a rising price, you do not expect, indeed you are not able to get rid of it at the same price or higher. Would you need your inventory reserve then?—I do not think one would use one's inventory reserve except for fairly urgent requirements. It is a reserve against a very serious fall, but the price of wool is not similar to the price of other commodities and when you have a tremendous rise as has occurred with wool you are liable to get a tremendous fall such as has subsequently taken place. But as far as possible one would take one's current loss against current trading profits on the way down.

2470. I thought what you had in mind was a reserve which really represented the additional cost in the year of carrying the same volume of stock as you opened with. Is not that the conception? If that is so it does not matter the next year whether the price goes down or not?—*Mr. Macpherson:* That is the conception as we understand the principle to work.

2471. I wanted to get at what you had in mind. You open the year with a certain volume of stock which has cost you whatever it has to acquire it. In the course of the year you get rid of it or part of it. If you get rid of it at higher prices you have a profit, but you have to carry on the business by getting more stock in and you have to pay a higher price. I thought in so far as you had to pay per unit a higher price for the new stock you made a reserve against it because you are trying to carry the same volume of stock at higher prices?—*Yes.*

2472. You carry forward the amount put to the reserve and you would use it in future years to write back into profits?—*Yes, on a reduction in replacement cost, that is to say, the difference between the value of the opening stock and the end stock for the same physical quantity.*

2473. Your profit is made on your sales, sales above the price which it cost you to acquire the stock. There is no writing up of the stock itself?—*Or against the replacement cost. It is rather a technical matter, but I understand that in the U.S.A. it is accepted in certain accounting quarters that you should charge against your sales the cost of replacement rather than the original cost of stock on the ground that you have to preserve your base stock, your normal trading stock intact.*

2474. What you are favouring is some method, however it is worked out technically, which would take account of the fact that a business has to carry throughout the years a certain volume of stock?—*That is right.*

2475. And if it costs it more to finance the carrying of that volume you say that should be a charge against the profits of the year?—*Yes, that is right.*

2476. That is what it comes to?—*Yes.*

2477. The other question you deal with is the taxation treatment of fixed assets, and in your third submission in paragraph 24 you say that account should be taken of replacement cost in determining the amount of depreciation allowances for taxation purposes. Are you thinking of actual replacement of the asset you are depreciating and would you allow it only if you replace or are you thinking of the proper measure of depreciation during the years you have the asset?—*That is rather philosophy than practice, is it not? I do not think we have any strong views about that provided sufficient provision is made to enable a company to replace its plant when the old plant has to be replaced.*

2478. It may make a considerable difference what you do. You cannot tell when you have bought a piece of plant which may have a ten, twelve or fifteen year life whether you are going to replace that plant or not?—*On the assumption underlying accounting practice, that a business is a continuing business, you would assume it would have to be replaced to continue the business after the estimated period of use.*

2479. You may have a different piece of plant or you may find that the money you have put aside you can more profitably use for some other purpose?—*Yes, I agree.*

2480. But what you are thinking of is a calculation year after year while you retain the fixed asset you have bought which will somehow compensate you for the loss of that asset over the years?—*I think there again that is making more technical than we wish to be. We felt it was necessary to provide the funds somehow if business was to be carried on with the same capital but whether that was done by an allowance towards the end of the period or annually with the use of scaled-up index figures, or whatever it might be, we felt was very technical. Our view would be on the whole we would favour a system which enabled the money to be provided annually over the period because from the point of view of those who have to provide the money for the business or for the carrying on of the business at the due date of replacement, and that is certainly part of our function, it is better to see it accumulate from year to year than wait for a renewal.*

2481. I follow that, but at any rate your main theme is that in a period of depreciating currency the historical cost of the asset is not the right test?—*Yes.*

2482. You start with that negative?—*Yes.*

2483. *Mr. Greenwood:* Just one thing on the question of issuing debentures, you gave reasons why that is not altogether a satisfactory solution to the problem. Would not the fact that these debentures have to be dated probably make it worse still?—*Yes, I think that is true.*

2484. They might have to be redeemed at a most awkward time?—*I think that is fair; that is recognised in most issues if possible by giving a span of years so the liability does not accrue at the least fortunate time; but it is so.*

2485. *Mr. Carrington:* First of all in regard to your submissions on profits tax, what would your view as to issuing houses be to the proposition that the system of taxing companies should be changed; that industrial profits earned by a company should be taxed in the hands of that company and that any further taxation should be on an individual basis. Following the practice of Canada and certain other countries, the individual would pay tax on his dividends as and when he got them, but the company would pay tax on its profits as and when it made them. In other words, there would be a separate company tax, amalgamating, if you like, income tax and profits tax, but one tax only on companies which would not be passed to shareholders or debenture holders?—*Mr. Keeling:* It would be very difficult to argue against it because as you say it is practised successfully in Canada and the U.S.A. I suppose one has that human feeling that it might be a method of getting a bit more out of all of us, but it has worked in those countries and it is clear our taxation without the complications we have got. I suppose I may not refer to E.P.L. but that has added considerable difficulties to the issuing houses.

2486. I gather, speaking at large, you would prefer it to the present system?—*I agree with you but we would only be expressing our own personal opinions on this particular point. It might be very controversial. I am not even sure that my Committee would agree with me, but as I have said it is very difficult to argue against a tax which has been working satisfactorily in Canada and the U.S.A.*

2487. It would be much simpler than our present three taxes on profits, income tax, profits tax and E.P.L.?—*Very much.*

2488. The next point I would like to raise with you is this. Is it your experience that companies have found greater difficulty by reason of inflation in relation to carrying stocks or replacing fixed assets?—*Mr. Macpherson:* It depends upon the industry but broadly I think undoubtedly carrying stocks; so far, I should add.

2489. So that taking your two submissions, some relief on stocks, which I will come to in more detail in a moment, or some relief on fixed asset depreciation, you think that industry as a whole would benefit more by relief on the stocks?—*Mr. Keeling:* Yes, I think certainly so taking the experience of what has occurred during the past few years. In regard to the other point, this may

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become more important in the future. If we were to keep up-to-date with other countries, particularly the U.S.A. where they spend a great deal on renewal of plant and on new and efficient buildings, the question of depreciating these assets assumes considerable importance.

2490. The U.S.A. do not allow depreciation on the replacement cost, but they have greater elasticity in regard to stocks than we have?—They still have the "certificate of necessity." As you know they have established many new industries in the last few years by granting a certificate of necessity which allows accelerated depreciation of up to 80 per cent. and in the case of armament firms 100 per cent.

2491. That is more on the lines of our special wartime legislation to encourage expenditure on defence projects?—It resembles initial allowances.

2492. No; what we had during the war. We had some additional depreciation allowances which were granted for wartime plants?—Accelerated depreciation has been allowed also for industrial plants not connected with defence.

2493. Is it not rather dependent on the nature of the industry?—It is, and I think it is more or less coming to an end now.

2494. It was a temporary measure?—Yes.

2495. Looking at the matter as a financial one, would you take the view that these additional charges against profit and loss account, either for stock replacement or fixed asset replacement should be made, even though it might involve placing the preference dividends on a company?—It must be so. One could not recommend a preference dividend if the inventory reserve was necessary.

2496. In other words, your Association would take the view that it would be a reasonable amendment of the legislation to require that if these allowances were granted, they should be given effect to, come what may, in the company's accounts?—Apparently in the U.S.A. it is a condition of claiming depreciation allowances. There can be no question of using it for both purposes, so to speak.

2497. I was putting the question rather more broadly than it arises in the U.S.A. I was postulating it, not only in regard to stock allowances but also replacement costs allowances in relation to fixed assets?—Mr. Proctor: I think if I may answer that, the making of a claim of such a nature for taxation purposes would not be possible unless the matter had been dealt with in that way in the company's accounts for all purposes.

2498. That is your view?—I think that is the view of the Association.

2499. Now coming back to a point of detail in regard to stocks, what would your view be in cases where current market value of stocks fell below the base stock figure?—Mr. Macpherson: That it should be allowed.

2500. In other words, you want the best of both worlds?—We would be starting at a fairly high price for stock.

2501. You would not get it in the U.S.A.?—Not yet; there is a Bill before Congress about it.

2502. Your view is that industry should be allowed to make these reserves in times of rising prices. If prices fall to a level below those existing at the time the new system comes in, then any fall in value below the base stock price, I see that phrase for short, is or should be the required charge for tax purposes and likewise should be provided for in the company's accounts?—That would be our view, taking the broad objective of encouraging industry, yes.—Mr. Keeling: I think also, if I may say so, from the point of view of issuing houses, we rather want to be sure that the stock is not overvalued. Whereas the tax authorities get the revenue sooner or later, it is a vital consideration when making an issue that investors should know with confidence that the stock has not been overvalued, and one hopes it is conservatively valued. It used to be considered prudent to have a conservative valuation of stock, but there has been a different approach to this matter in recent years, which has caused trouble.

2503. Have you or your accounting advisers come across any cases in practice where the base stock method is already followed in this country?—Mr. Macpherson:

I do not know whether Johnson Matthey is a case in point. It is not perhaps technically base stock, but it has the same sort of effect.—Mr. Proctor: I think the answer to that is "yes" and one particular example is Johnson Matthey, who do for certain of their stocks deal with them at a base price which is not allowed for tax purposes, and the Chairman has from time to time commented on that fact in his annual statement.

2504. But it is an acceptable accounting practice provided it is disclosed in the accounts?—Yes, provided it is made clear.

2505. You know there has been a decision by the Special Commissioners that a base stock method is admissible for tax purposes?—I am aware of that, but I cannot say my experience has been that it has been followed in practice by the Inland Revenue Department.

2506. Mr. Crick: The major complaint in the first part of your paper is that, having regard to the standards of what may be called sound company financial structures, there has, since the war, been too much resort to the raising of loan capital, broadly speaking, and too little resort to the raising of risk capital. That is your submission?—Mr. Macpherson: A tendency towards that, yes.

2507. Now your concern is mainly with companies of substantial or large size?—No, Sir, a great variety.

2508. Do you get down to the small company elements?—We have to advise them, certainly.

2509. Then you can answer my next question which is this: Is that feature, which you have spoken of, as apparent or more so among smaller companies as it is among larger companies?—I should say very much more so.

2510. You would regard that as perhaps making the conditions even more undesirable and harmful than you would consider them in the case of big public companies?—Yes, Sir, I would.

2511. You would, I think, agree that there are a number of other factors in the situation. For example, stamp duties bear upon this problem, I believe?—Yes, that is true.

2512. Costs of issue would bear upon this problem?—Yes.

2513. The standing, I mean standing in the eyes of the public, of the company concerned would bear upon the problem: so that taxation is not the only factor by any means in the situation?—No, Sir, but it is an important factor and it can be an over-riding factor.

2514. There are cases, are there, in which you would say taxation has definitely swung the decision in favour of loan capital?—Yes, very definitely.

2515. That is so, is it?—Yes.

2516. On this difficulty of raising risk capital, I suggest one has to look at it partly from the point of view of the demand side and partly from the supply side. Would you suggest that another element in the problem is the scarcity of money available for investment in risk capital?—Yes, certainly.—Mr. Keeling: And becoming increasingly so.

2517. To what do you attribute that?—Mr. Macpherson: I think there are probably two sides; first of all, the cost of living bears very heavily on private individuals; secondly, that the reserves available to public companies from which other risk capital comes are not as great as they would be if taxation was a great deal less, and thirdly, I think venture in industry is not under present taxation conditions very attractive except in the great companies which are perhaps what you might call grade A ventures rather than the smaller companies which would not be regarded as grade A quality.

2518. If the conditions were right, do you think private capital would be forthcoming readily for new investment?—I think it would be more readily forthcoming.

2519. I wondered if you felt taxation on the personal side was affecting the flow of funds available for equity investment?—Mr. Keeling: There is no question at all, over the last 20 years the position has changed absolutely and completely and it is a matter of considerable anxiety to my Association as to what is going to happen in the next 20 years if the same graph is continued. Twenty years ago the most important investor was the private individual. The investment trust company often formed to help the private

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individual invest his money was the next most important and insurance companies were low down on the list. Over these 20 years the insurance companies as we all know are through the roof; the pension fund which is the new source of savings (it is so difficult for the richer people to save) comes second. The investment trust companies have in recent years remained static and the individual large investor has been rather living on his capital than able to save the money which would be new money for industry.

2520. So the trouble to which you are referring here is not due solely to the taxation of company profits, but in your judgment may be also a reflection of taxation on personal incomes?—Very much so. In effect really our general submission is that industry as such is being over-taxed and the individual is also because he cannot provide the money, or may not over the next 20 years be able to provide the money, which will be required to finance industry.

2521. I gather in these circumstances there is a trend, on your observation, to more and more institutional investment as against personal investment?—There is no question about that.

2522. Do you regard that as deplorable?—I think that the greater the spread of investors the better for the country taking the long run.

2523. But one way of getting that spread is by institutional investment, is it not?—Indirectly, yes.

2524. I am anxious to get your views, if you hold strong views, on the question whether the extent of institutional investment, which is one consequence you suggest of the pressure of taxation, is a good or bad thing, broadly speaking?—Mr. Macpherson: It involves fewer decisions and fewer choices among investments. The investment decision is concentrated in a relatively small amount of investors, that is to say, institutional investors. It is true the beneficiaries are scattered through the people who depend on that institution, but the decisions regarding investments are made by a very limited number of people. There are various things that appeal to different people and it is by no means certain the smaller group of investors would be right. It is not necessarily true the smaller the group, the more right they are.

2525. You would not like to guess which way it goes?—Mr. Keeling: I think to some extent it is a question of degree. The institutional investors in recent years have been absolutely invaluable in the raising of fresh finance and every day become more and more important. Whether one would want the institutional investors to be only a very limited number, taking a long view, I am not so sure.

2526. When you are speaking of the development of industry and the difficulty of financing, I wonder if you would consider this point. In para. 22 you refer to the difficulties experienced by companies, big and small, in financing their businesses from internal sources. Would you feel disposed to make a distinction between financing their businesses on the current level and financing expansions of the business?—Mr. Macpherson: I think it is fair to say there have been great difficulties in financing businesses at the current level. That was the object of the case C which we submitted here, where the business was precisely the same. There was little variation in the throughput or the amount of stock that was being financed, yet the amount of money that was required was very substantially greater and the chance of financing the maintenance of that business at the current level was endangered by the fact that they had to find a considerable amount of taxation on the appreciation on their stock.

2527. You would lay it down as a principle that business on the current level ought to be financed from internal sources?—Mr. Keeling: The normal development of a business should largely be out of its own resources as opposed to some new venture of a large size when there has always been recourse to the capital market for the funds required.

2528. You would suggest that the normal growth and expansion of the business ought not to entail the issue of new capital?—It is a question of degree, I think. In recent years there have been very high stocks to finance which has taken away the money, so they have not had anything to spare for the normal expansion of business, apart from the development of new enterprises such as have been undertaken by chemical companies.

2529. I think you suggested earlier that the unpredictability of the rate of profits tax was a further obstacle to sound company finance; am I right?—Mr. Macpherson: Yes, Sir.

2530. This is a related point. I wonder if you have any views on the desirability of the differential rates of profits tax as against a possible alternative of a flat rate, irrespective of whether the profits are distributed or not, to yield approximately the same revenue?—Of two evils, I think we prefer the flat rate.

2531. Can you tell me why?—I think it is largely due to the complications that a differential rate involves. As a pure matter of practice you do not know what dividend you can pay until you have worked out your taxation or your taxation until you know your dividend and it is very much more difficult to explain to people who are not skilled in taxation matters and figures?—Mr. Keeling: I think it adds to the complication of writing a prospectus where you have these two different taxes.

2532. It is a practical matter rather than a difference of degree in effects or anything of that kind?—I think one's feeling is that these new taxes started by being political and anything political always adds complication to our normal business life. The present system of taxation with income tax, profits tax and now E.P.I. makes the drawing up of any document or the forecasting of results extremely difficult.

2533. Then there is one question I should like to ask you on your first submission which occurs in paragraph II. The submission is that profits tax as at present levied should be replaced by other taxation less conducive to unsound capitalisation. Have you any particular alternative in mind?—Mr. Macpherson: No, Sir.

2534. You leave that to us to discover?—Yes.

2535. Mr. Keeling: Just one or two questions. I think we must distinguish between the burden of taxation, which may be very heavy, and the methods by which it is raised. Supposing the Government wants to raise a certain amount of tax on profits, any narrowing of the base of that taxation would necessitate the raising of the rate of taxation, would it not? In view of that would you say, if confronted with your first problem, that of the profits tax on preference dividends, it would be better to relieve the preference dividends of profits tax or to bring the interest on debenture stock into charge as profits?—Mr. Keeling: I should not like to suggest extending the already extended base. I think we might answer the question generally like this. It has been, I think, accepted always that loan interest has been a charge and I would hate to see that one charged, but I think generally we would prefer one simple tax, and we would prefer it to be income tax. If there must be a special levy against industry, it should be one further tax, a profits tax.

2536. May I put the question in another way. Supposing the Government could relieve industry of some of the profits tax by reducing the total amount raised in profits tax, would you say it is better to do this by reducing the rate of tax, or by giving bigger tax free allowances; for example, bringing preference dividends as a charge against profits computed for tax? There may be many others. That is the sort of problem I want to put to you.—Could I put the question another way; if we could get what we liked in regard to this stock reserve and depreciation, would we prefer that and have a larger tax on the company?

2537. On the last?—If it were a question of depreciation or stock reserve on L.I.F.O. principle or whatever form it may be taken, I would say we would prefer that and a higher rate of tax on the balance.

2538. But not necessarily as regards this other point of whether preference dividends should be allowed as a charge. It has already been mentioned by somebody that that means a bigger burden on the ordinary shareholder unless you reduce the total tax burden. If you do, the question arises is that the best way of doing it?—On the question of preference shares, there are two main objections. One is that it has a very unfair incidence through just the chance of how companies were capitalised in the old days. One company may have capitalised itself in one way and another company in some other way, and it is very unfair. The second objection from the point of

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view of issuing houses is shown by the fact that there have been very few issues of preference capital in the last six months or so. One of the reasons for this certainly is that companies, if they feel that there is any chance of this tax on distributed profits continuing, have to add approximately 50 per cent. to the rate of preference dividend which they will have to pay, which today may be 54 or even 6 per cent., making the total cost nearly 9 per cent. Taking the long view this is extremely unfortunate as there are only three main methods of making issues, by way of loan capital, preference capital and ordinary capital. It is not always desirable to issue Ordinary Capital, so if the issue of Preference Capital is too expensive, this does away with what has in the past been an extremely valuable form of financing.

2539. Just one other question I wanted to ask. You favour the creation of an inventory reserve which would be relieved of charge to tax, but that comes to very much the same thing as this American L.I.F.O. method. You do not prefer that because when prices do fall, under the L.I.F.O. method a company is more heavily taxed than it is under the present British system?—Yes.—Mr. Macpherson: I think I should explain that "inventory reserve" is really used in a very untechnical way. As my Chairman has said, we do not pretend to be accountants and economists, therefore we did not want to use very technical phrases. I think it is fair to say that the sub-committee, when they use the words "inventory reserve" have in mind a deduction in the form of L.I.F.O. rather than the creation of a specific stock contingency reserve, whatever it may be called.

2540. But you would stick to that throughout, would you, in valuing stocks on the last in first out basis?—Yes.—Mr. Keeling: Surely the valuation of the stock would not under any circumstances be above cost or market. That would have to be the limiting factor.

2541. Chairman: I did not hear what you said?—I was asking Mr. Proctor what he thought. I take it that even on the L.I.F.O. basis stock would not be valued above cost or market.

2542. Sir Geoffrey Hayworth: Not on the American system. Once you elect for L.I.F.O. in America you have to stick to it, and you can get into the position where your valuation would be above market?—Mr. Macpherson: I think the answer to that may be, but brought in the L.I.F.O. system in America in 1938 so that the question of the use of market value has not as yet in practice arisen.

2543. The answer is you opt for L.I.F.O. when you think it is never likely to happen that your market cost will be below that basis?—That, after all, only happens to be the way L.I.F.O. is applied in the U.S.A. It is not an essential ingredient of a system for providing for inventory reserves of this kind. Certainly our view would be at this stage of the price cycle, having regard to what companies have suffered on the way up, it is necessary to allow for cost or market if prices fall below your L.I.F.O. basis value. As Mr. Kaldor said, under our system, as in L.I.F.O., when stock losses were being made we might have to pay more tax than at present when stocks depreciate.

2544. Mr. Kaldor: I am sorry, I merely wanted to elucidate. I thought the difference was this. What you are suggesting is to allow companies to set aside the reserve in times of rising prices and that that part of the profits which is so set aside should not attract tax.—Yes.

2545. Otherwise leave the existing methods of stock valuation as accountants practise it unchanged?—Yes.

2546. That would have the effect in times of rising prices that companies can set aside this reserve tax free. But in times of falling prices they would still get the benefit; they would in that case be getting an inventory loss which reduces the tax charge below what some economists call a real profit.—Mr. Keeling: I think if a method could be evolved of doing that it would be extremely satisfactory from our point of view. Probably we favour the L.I.F.O. as we have been looking round for a way to deal with something which has been a very real problem.

If we were to elect at the top of the boom to have L.I.F.O. it might be the worst possible thing.

2547. Would it be your suggestion that if L.I.F.O. is the alternative to your present system this may not be the fortunate time at which to introduce it. It may be better from the point of view of industry to wait for a better time to introduce it, if you are expecting a period of boom?—Mr. Proctor says it would presumably be optional.

2548. Mr. Carrington: Just one point arising out of questions put by Mr. Crick. Mr. Crick asked you in regard to profits tax, whether you would prefer a flat rate as compared with the present position of a differential rate as between distributed and non-distributed profits and that leads me to make an enquiry of you on another point. Have you any views concerning the contingent liability of companies for the repayment of non-distribution relief that they have received under the present system?—Mr. Macpherson: A gloomy one, so far as we understand it.

2549. Have you any submissions to make in regard to that position?—I think we would feel that that contingency should be removed. At the present time as I understand it the position is that you are charged at a level of tax and given relief which has to be accounted for later if you subsequently distribute in subsequent years. If we have to keep a differential system I think that method of charge should be abandoned. You would just be charged at the present rate on your undistributed profits and your present rate on distributed profits with no contingency left over.

2550. Under a flat rate system such as that mentioned by Mr. Crick this would not arise?—It would disappear.

2551. Another point arising out of Mr. Crick's questions, you mentioned that the growing importance of institutional investors narrowed the field so far as decisions on investment matters was concerned, and in the course of the answer you mentioned also pension funds. Having regard to what is being considered in another committee, do you regard pension funds as desirable investors in industrial companies or have you any feeling of uneasiness about a position which might develop where pension funds were holding very considerable blocks of shares?—Mr. Keeling: I have myself personally very strong views on this subject. It is very easy I think for the directors of a pension fund to take the simple course and invest in gilt edged, particularly at times like this when one hopes they are bound to go up and not go down, but there are already the savings movement and the savings banks which are collecting money to go into gilt edged securities. My own feeling is, though it may not be generally accepted, that it is a duty for some part anyway, some considerable part, of the money which has been obtained from industry and which goes into the pension funds to be returned to finance, either directly or indirectly, industry in the future. I feel strongly that pension funds have arisen through industry and that part of these funds anyway should be returned, directly or indirectly, to industry.

2552. So you do not regard it as a danger point that there would be an increasing flow of pension fund money into company investments?—We should welcome it. Mr. Macpherson: The only possible way of getting the risk capital of the future may be from such investors if present trends continue.

2553. The reason I asked the question was this. I had heard it suggested elsewhere this was possibly a danger point for pension funds to become the major investors in industrial equities.—Mr. Keeling: I think it is one of the few ways one can see of getting the savings of the people into industry because the ordinary small chap will not invest in an industrial security. He puts it in the bank or into savings certificates or a gilt edged security and the only hope, taking the long view, of getting money back into industry is largely through these pension funds which are already collecting large sums of money.

Mr. Carrington: Thank you. You have answered my question completely.

Chairman: We are much obliged to you gentlemen for coming and for the help you have given us.

The witnesses withdrew.

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PROFESSOR F. W. PAISH

[Continued]

PROFESSOR F. W. PAISH; called and examined.

MEMORANDUM SUBMITTED BY PROFESSOR F. W. PAISH

THE ESTIMATION OF BUSINESS PROFITS IN PERIODS OF
CHANGING PRICES

1. It is not the purpose of this memorandum to present in any detail the case for allowing such amounts to be set aside from business profits before tax as would enable the "real", as opposed to the money, value of the capital of the business to be maintained intact. The Commission has already heard much evidence on this point, and there is little that I could usefully add to it now. My main purpose is to attempt to find a convenient criterion for the maintenance of real capital intact, and to make suggestions about possible methods of achieving it. All that I wish to say here on the general subject is that I support a definition of business profits which would provide for the maintenance of real capital intact for reasons not only of equity but also of public interest. I believe that to base estimates of profit, both for tax and other purposes, on the maintenance merely of the money value of the assets of a business tends to promote over-spending and over-taxation in times of rising prices, and under-spending and under-taxation in times of falling prices. Thus existing methods of estimating profits tend to intensify both booms and slumps, unless indeed their effects are offset by deliberate Government action in the form of Budget surpluses in times of rising prices and of Budget deficits in times of falling prices. I consider that it would be most desirable to relieve the Government of this responsibility for providing a compensating mechanism to obviate the disorienting effects on the economy of our present methods of estimating profits.

2. As a temporary offset to the excessive taxation imposed on businesses in times of rising prices by present methods of estimating profits, the Government granted in 1945, and increased in 1949, a specially high rate of depreciation allowance on new plant and equipment during the first year of its life. This initial allowance, which is now about to be withdrawn, probably brought the aggregate amount of depreciation allowances throughout the country up to something like the actual cost of maintaining the total of real fixed capital intact. While, however, the aggregate amount of depreciation allowed was probably about adequate between 1949 and 1951, the method used had at least four serious shortcomings: it was essentially a temporary concession, for the more the depreciation allowed in the early years of a piece of equipment, the less there will be in its later years; its benefits were distributed between firms, not in proportion to the equipment they had to maintain intact but in proportion to the new equipment they installed; it made no attempt to deal with the problem of tax on book profits due to the rise in the recorded values of physically unchanged inventories; and above all it acted as a subsidy to new investment at a time when investment was in any case tending to outrun saving, and thus undid such anti-inflationary effect as it had through allowing businesses to increase their savings. Its discontinuance is therefore to be welcomed; but its absence makes essential its replacement by a more rational method of allowing businesses to set aside out of profits before tax sufficient provisions to enable them to keep their capital intact. The urgency of some new provision after the withdrawal of the initial allowance is clear if we consider the estimate of the finance of investment for 1951 given in the Economic Survey (Cmd. 8195, Table 26). This shows that in 1951, after setting aside £1,120 Mn. for depreciation and £530 Mn. for increased tax reserves, the undistributed profits of businesses were estimated at £780 Mn. But of this sum, no less than £700 Mn. was expected to be needed to cover the increased cost of stocks of unchanged size, leaving only £80 Mn. for actual increases in fixed or working capital. Now Table 6 of the National Income White Paper (Cmd. 8203) shows that out of £1,124 Mn. of depreciation allowed in 1950, £250 Mn. was due to the initial allowance. If, therefore, the initial allowance had not been in existence in 1951, provision for income and profits tax would have had to be more than £130 Mn. higher and net business savings would have been put at some £50 Mn. negative. In other words, taxes

would have taken more than all the amounts that business was able to put aside after making provision to maintain its capital intact.

3. It is sometimes suggested that the correct method of deciding whether a business is setting aside sufficient amounts from its profits to maintain its real capital intact is to ascertain whether the amounts set aside would be sufficient, if reinvested continuously in the business, to maintain the assets of the business physically intact. This "replacement cost" criterion, however, is not necessarily satisfactory, though it is likely to be a much closer approximation to a solution of the problem than the present "original cost" criterion. The reason for the possible inadequacy of the "replacement cost" concept is that all prices do not change at the same rates. Even in a time of a generally stable price level, some individual prices are rising and others falling. Owners of assets which rise in price relatively to the general level obtain a real advantage thereby. For owners of non-durable goods, such as stocks of unbridged raw materials, this is fairly obvious. The owners of a large stock of raw cotton at a time of a short crop and a sharp rise in cotton prices will be in a favorable position as compared with other manufacturers whose stocks are small. If prices of finished goods rise commensurately with raw material prices, those with large stocks will benefit immediately. If, on the other hand, prices of finished goods do not show an immediate rise, those manufacturers who must buy raw cotton at the higher prices in order to produce at all will find production unprofitable and will be unable to continue to produce. Output of finished goods will, therefore, fall and prices rise until they reach their normal relationship with that of the raw material. Those with large stocks, who have been able to stay in business, will then reap an exceptional profit as long as their old stocks last.

4. The same considerations apply, though perhaps rather less obviously, to owners of durable assets of which the replacement cost has risen. Unless prices of finished goods also rise, anyone investing in new fixed assets at the higher prices will earn less than the return on other types of investment. Not only, therefore, will new competitors be deterred from entering the industry and existing competition from expanding their output, but those whose assets wear out first will find that it does not pay to replace them. Output of the finished product will therefore fall, prices will rise and those with the longest-lived assets will find that for the remainder of their assets' lives they will make an abnormally large profit on their original cost.

5. Since other prices have, by definition, fallen slightly, the owners of these assets will obtain a higher yield not only in money terms but also in real terms. As they have obtained a real benefit from the rise in the value of their assets, there is no reason why this should not show as a profit in their accounts.

6. Similarly when all prices are rising, but some faster than others, owners of assets of which the replacement cost has risen unusually fast obtain a real advantage as compared with those whose assets have risen more slowly; and it is reasonable that this differential advantage, though not the whole rise in replacement costs, should be reflected in their taxable profits. It would, therefore, seem that it is only that part of the rise in their book profits which is due to the general fall in the purchasing power of money which should be excluded.

7. The obvious way of adjusting for a general change in the purchasing power of money is to calculate profits in exactly the same way as at present (subject to any changes which are thought desirable on other grounds) and then to make special adjustments at the end of each year in order to eliminate those book profits which are due to the change in the general level of prices (or, in times of falling prices, add back book losses due to the same cause). For this we should need a general index of prices, and not merely an index of prices of any one

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[Continued]

commodity or group of commodities. No such general price index, covering industrial as well as consumption goods, exists at present; but it would not be difficult to construct one which would give a more satisfactory result than any now in existence. For purposes of illustration, I have made a very rough guess at such an index, based on 1938, which I give below, showing also for comparison the London and Cambridge Index of Retail Prices and the Index of Prices of Consumption Goods derived from the figures of consumption at 1948 and 1938 prices given in Cmd. 8203.

	Index of Retail Prices	Consumption Index	General Price Index
Av. 1938	100	100	100
" 1946	150	157	162
" 1947	160	169	177
" 1948	173	182	189
" 1949	176	185	194
" 1950	184	191	201
" 1951 (Prov.) ...	200	210	226

8. While the general price index is very rough, the difference made by more refined methods could hardly be very great; for so large a proportion of all goods and services used at home enters into personal consumption that no general index could depart very far from the consumption index.

9. The ways in which the price index would be used would depend on the class of asset involved. Business assets may be divided for our purposes into six main classes:

- (1) Land, non-industrial buildings and other fixed assets on which no depreciation is allowed.
- (2) Plant, machinery and other fixed assets on which depreciation is allowed.
- (3) Stocks of raw materials, goods in process and awaiting sale. These will be referred to as "inventories."
- (4) Investments in the ordinary shares of other companies.
- (5) Long and medium-dated fixed-interest investments.
- (6) Short-dated investments, debentures and cash. These will be referred to as "money assets."

10. The first class of asset would not be affected by any proposed adjustment. The second class would be depreciated as at present, and the depreciation allowance would then be increased by the amount of the rise in the general index since the year in which each particular asset was acquired (it would probably be convenient to regard all pre-war assets as having been bought in 1938). The original depreciation would be deducted, as at present, from the value of the asset, and the adjustment would be placed to a special replacement reserve account.

11. As an example, let us assume that a firm has £200,000 of depreciable fixed assets which, for the sake of simplicity, we will say were all bought in 1946, and on which depreciation for 1951 on the existing basis would be £20,000. Since the general price index for 1946 was 162 and for 1951 was 226, the additional depreciation to be allowed would be £20,000 × $\frac{226}{162}$ — £20,000,

or £29,000, which would be deducted from taxable profits and placed to replacement reserve. If at some subsequent date, the general index of prices should fall, so that in the current year it stood below its level in the year in which the asset was bought, there would be a deduction from the normal depreciation allowance which would be charged against the balance standing in the replacement reserve and added to the profits for the current year.

12. The present method of dealing with our third category of assets, inventories, is to include in taxable profit the whole of any increase in the book value since the beginning of the accounting period, even though in physical terms the closing stock may be smaller than the opening stock. It is desired to exclude from the total of taxable profits any book profits which are due merely to the rise in the general level of prices. If stocks

are fairly stable in quantity throughout the year, it will be sufficient to deduct from book profit and to add to replacement reserve an amount equal to the difference between the book value of the opening stock and the same value multiplied by the percentage which prices at the end of the year are of those at the beginning of the year. Let us assume that the book value of a firm's inventory on 31st December, 1950, was £180,000, and on 31st December, 1951, £200,000. Let us also assume that the index of general prices stood at 204 in December, 1950, and at 235 in December, 1951. The adjustment in profits for the effect on inventories of changes in

the general level of prices will be £180,000 × $\frac{235}{204}$ — £180,000, or £27,400. Together with the adjustment on the depreciation of the fixed capital there will be a total deduction from profits as at present calculated of £35,300.

13. Where the level of inventories changes markedly during the year a modification of this method will be necessary. A simple adjustment would be to take the average of the appreciation due to the rising general price level in the opening and closing stocks: e.g., opening stock £180,000; closing stock, £190,000:

$$\frac{£180,000 \times \frac{235}{204} - £180,000 + £190,000 - £190,000 \times \frac{235}{204}}{2}$$
 equals $\frac{£27,400 + £13,500}{2}$ or £20,450.*

Including the additional depreciation allowance, this would bring the total deduction from taxable profits to £28,200.

14. No action needs to be taken with regard to class (4) of assets (equity investments), or at this stage to classes (5) and (6) (fixed interest investments and money assets). If a business financed wholly on equity capital decides to invest part of its capital in fixed interest securities or money assets, it will suffer a real loss in times of rising prices in exactly the same way as a private investor would.

15. It is sometimes urged, in opposition to proposals for relieving productive industry from taxation on fictitious profits due to a fall in the general purchasing power of money, that since individuals or companies who hold money assets or fixed interest securities lose part of their real capital in times of rising prices, it is only fair that owners of productive physical assets should also suffer a loss. This contention does not appear to be well-founded. The ownership of productive assets carries with it many risks which are not shared, or are shared in a much smaller degree, by owners of claims fixed in terms of money. To require the owners of productive assets to carry, in addition to the risks peculiar to the function of entrepreneurship, the risks which are proper to lenders, is not only unjust but likely to have undesirable social results. In particular, it makes the ownership of productive assets relatively less attractive in times of rising prices than the ownership of non-productive assets, and may well make the hoarding of goods a better hedge against inflation than a share in the ownership of a productive enterprise.

16. While, however, this particular criticism appears to be unjustified, it may well be based, perhaps sometimes unconsciously, on another which, though rarely expressed, has much more validity. This criticism is that, while a business in a time of rising prices is taxed on fictitious profits, it escapes tax on the benefit it receives from the diminution in the real burden of its liabilities. Thus, although the reductions in taxable profit as proposed above would be wholly apposite to the case of a business financed wholly on equity terms, for a business with substantial liabilities or fixed dividend capital the resultant position would be much too favourable. For a completely satisfactory scheme for eliminating the distortions in taxable profits due to changes in the purchasing power of money, we must include adjustments not only for the rising prices of assets but also for the falling burden of liabilities.

* If the level of inventories shows large seasonal fluctuations, it may be necessary to estimate the amount of nominal profit which is due to the effect of the rising general level by reference to an average of monthly inventories instead of merely the opening or the opening and closing figures.

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[Continued]

17. The simplest way of allowing for the fall in the burden of liabilities would be to treat all liabilities and fixed dividend capital as negative inventories, and to add back to profits the whole of the difference between their value at the beginning of the year and the same figure divided by the percentage which prices at the end of the year are of those at the beginning of the year. It will, however, be only fair to allow any fixed interest investments and money assets to be offset against fixed dividend capital and liabilities, and to calculate the benefit which the business has received from the effect of the rise in the general level of prices with reference only to the net values. Let us assume that at the beginning of 1951 the business was considering had among its assets fixed interest investments of £50,000 and money assets of £100,000, while its liabilities consisted of £200,000 of debentures and £50,000 of short-term debts. Deducing its fixed interest investments and money assets from its liabilities, we have net liabilities of £100,000 at the beginning of 1951. The gain from the fall in the real value

of these during the year is $£100,000 - £100,000 \times \frac{204}{235}$ or

£13,300. As the amount to be deducted from profits on account of assets was £35,300, and the amount to be added to profits on account of liabilities is £13,300, the net amount to be deducted from taxable profits and placed to replacement reserve account is £22,000.

18. If the total of liabilities changed greatly during the year, it would be possible to average the adjustments between the opening and closing liabilities in the same way as we averaged the adjustments between the opening and closing stocks in the example given in paragraph 13.

19. In a period of falling prices, the adjustments made by the method suggested here would operate in the opposite direction. The fictitious losses made through the

fall in the book value of assets due to the fall in the general level of prices would be added back to profits and deducted from the replacement reserve, while the real losses made through the rise in the real value of liabilities would be deducted from profits and added to the replacement reserve.*

20. It is extremely important that profits should be adjusted in this way, not merely for tax purposes, but also for the business' own purposes. Under the present system, high nominal profits in times of rising prices and apparent losses in times of falling prices may not only affect the amount of tax paid but also mislead directors and shareholders. This is especially important in times of falling prices, when the publication of fictitious losses may well cause unjustified pessimism and prevent profitable investment from being undertaken. Merely to add to tax liabilities at such a time would probably serve to intensify the pessimism and prolong the depression; but if accountants and directors could be brought to keep their accounts in such a way as to show an often substantial real profit in place of an apparent loss, the higher liability to tax would be more than offset by the more satisfactory profit position. If not only the Inland Revenue, but also business men in general could be brought to think in real, and not merely in money terms, it would go far to modify the violence both of inflationary and of deflationary movements.

25.2.1952.

* In view of the possibility, though not at present very probable, even of prices falling so sharply that withdrawals exceeded the amount of the replacement reserve, some amendment of the existing Companies Act would be required to permit the scheme suggested here to be adopted in full.

EXAMINATION OF WITNESS

2554. *Chairman:* You have sent us in a document to which we have all given careful attention. Perhaps to get the basis of your paper I might quote the sentence in paragraph 1:

"My main purpose is to attempt to find a convenient criterion for the maintenance of real capital intact, and to make suggestions about possible methods of achieving it."

That is what you set out to do?—That is roughly the main purpose.

2555. Then you go on to consider the system of initial allowances which, as you say, has recently been abandoned and you give us four defects you attribute to that system?—Yes.

2556. Then I think in paragraph 3 you consider the criterion of replacement cost. I do not know exactly what that means. You think that is not in practice altogether a satisfactory method of achieving your aim.—A great improvement on what is at present, but not thoroughly satisfactory.

2557. What actually have you in mind about replacement cost? A calculation each year of what it would cost you to replace the asset in the depreciated form of that year?—Yes. It is extremely difficult where you are replacing with something entirely different from what you have had, particularly where you are replacing fixed capital. It is normal to replace stock in trade with something similar to what you have had, and it would be possible in most cases to have an index of the actual things you were replacing or take the actual things unit by unit and say what it would cost to replace them.

2558. It would be like charging the cost of restoring your stock against the profits you have achieved by selling your old stock?—Yes.

2559. And with the larger problem of the fixed asset . . . —It would be extremely difficult to interpret it at all precisely.

2560. Then you go on in paragraph 7 to come to what I think is the method you are going to work out for us. You say:

"The obvious way of adjusting for a general change in the purchasing power of money is to calculate profits in exactly the same way as at present (subject to any

changes which are thought desirable on other grounds) and then to make special adjustments at the end of each year in order to eliminate those book profits which are due to the change in the general level of prices (or, in times of falling prices, add back book losses due to the same cause)."

The question I wanted to ask you in order to clear my mind is this. When you are dealing with fixed assets which you are using year by year for the purpose of your business, the change in the general level of prices does not affect your profits, does it?—It affects very much the cost of the goods you have to buy to replace those of your fixed assets which are worn out year by year. Therefore to keep the scale of your business unchanged and your output unchanged you will have to put more into the business than the original cost of the assets that have been worn out and you have to make some provision in the same way if you are going to maintain the physical size of your business without steadily shrinking to get that additional capital to replace assets at increasing prices.

2561. I quite follow. In a year in which you have to replace a fixed asset you meet the burden of the increased cost in replacing it—I am assuming, which I think is the typical case, a business where you are continually replacing year by year. There are particular and special problems where you replace discontinuously as in a firm with a few large items such as ships, where you have to hold cash, but I think the other is the more normal and typical firm.

2562. You say most businesses contain a variety of fixed assets and by and large you will find that something year by year has to be replaced?—In a large business pretty continually year by year.

2563. Supposing you were facing the situation in which for two or three years though working your plant and machinery and using your fixed assets, you were not faced with the immediate problem of replacement.—In any period of rapidly rising prices there will be the problem of keeping the purchasing power intact. In that case you will have to set aside in cash an amount to meet an exceptional replacement in a few years' time and it may be an insuperable problem to maintain the value, the purchasing power, of that cash intact during the two or three years while you are accumulating the exceptional lump sum.

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PROFESSOR F. W. PAIR

[Continued]

2564. Just to pause there for a moment: your problem then becomes one of how you are to calculate money you are to set aside each year?—I think the only thing you can do is to calculate them in some way and try and find some means of, say, investing them that they maintain their value. That is one of the reasons why a large and integrated group has certain advantages because if one company of the group is setting aside money it has no immediate use for, it may very well be that another company of the group can find a use for it; therefore it is being put into fixed tangible assets immediately and has no time to lose purchasing power. Otherwise the suggestion has been made that the only thing you can do is to speculate in some commodity whose price was likely to rise, at least parallel with the fall in the value of money.

2565. But it is part of your suggestion, is it not, that you should re-calculate these provisions according to an index which you have roughly produced?—Yes.

2566. The purpose of that is to re-calculate in the case of fixed assets the annual provision?—Yes, to adjust, to add or deduct. You would calculate the annual provision as at present and then make an adjustment up or down accordingly.

2567. The adjusted sum, if it is larger than the normal depreciation, you would transfer to a special account, what you call a replacement account?—Yes.

2568. What is the fate of that account supposing at the end of the life of your fixed asset you find it is more or less than you needed?—It is not related to the life of any particular fixed asset. It would mean that if at some future date you should find that in making your adjustment you have to reduce your depreciation allowance for the year below what it would be as at present calculated, the difference would be debited to that account, and theoretically there is no reason if you start at the peak of prices and prices thereafter fall, why that amount should not appear on the other side of the balance sheet. It ought really to be called "account for adjustment in the purchasing power of money" and it could be equally well on either side of the balance sheet according to where you started.

2569. Then you come in paragraph 12 to the category of assets represented by your stock inventories. You say:

"It is desired to exclude from the total of taxable profits any book profits which are due merely to the rise in the general level of prices."

You mean the closing account of stock which shows the increased cost you have paid to acquire it?—It need not be identical with the extra amount you have paid for your particular assets because as I have tried to explain earlier, your particular assets may have moved differently from the general prices. Say your assets stand at £105,000; that is only the same as £100,000 was at the beginning of the year. It is really an attempt to try to keep your accounts in money of unchanged purchasing power.

2570. But does that take account of the fact that the actual volume of your opening stock and the volume of your closing stock may be quite accidental at that moment?—I have tried to suggest possibilities. If the volume of your stock is fairly constant it would be enough probably to work on your opening stock. If the volume of your stock changes through the year at an even rate, then an average of your opening and closing stocks would be adequate. If your stock fluctuates violently during the year from month to month or quarter to quarter, you would have to have some rather more elaborate arrangement such as doing this monthly, but I imagine that for most types of business is unlikely. There are some businesses which do a highly seasonal business, but I imagine that is not the majority of businesses.

2571. The basis of your adjustment index is really domestic prices?—Yes, a general level of domestic prices.

2572. Is that satisfactory if you are going to adjust in respect of the cost of goods acquired in the world market?—I think so, because what you are measuring among other things is what your dividends will buy. I think it is fair to say that, if there is a much bigger rise in world market prices than in domestic prices, people who hold a large stock of imported goods are really, as

well as apparently, better off; and the difference between the cost at imported prices and the rise in home prices is a real gain to anybody who holds a large stock as compared with anybody who does not.

2573. Then you go on in paras. 16 and 17 to deal with the real gain which it may be said a business achieves by being able to pay its money liabilities and its fixed dividends in depreciated money?—Yes.

2574. And your suggestion is you should treat the liabilities and the fixed dividend capital as negative inventories?—Yes, which is much the simplest way of handling it.

2575. It really means looking at the capital value of those liabilities?—Yes. Broadly speaking, it is the amounts you have to repay when they mature.

2576. Yes. I was rather puzzled at the suggestion you should look at these things when really you are only concerned with the annual service of the interest or the dividend according to their capital value rather than the annual cost for this purpose.—Most of them will have to be repaid and every time there is a rise in prices the burden of that prospective repayment falls as well as the burden of the current service. Or if you are thinking, as one ought to think, of amortising them, then the burden of the total amortisation, including interest, falls.

2577. But are they not really more like your fixed assets than your inventory stock?—I think that is perfectly true, and it would be possible to treat them, that is to say, the long dated securities as negative fixed assets, but that would involve a considerable complication. One would then have to look at one's own long term investments as a positive fixed asset. Instead of taking capital from capital, one would have to have a series of amortisation quotas on both sides which you would take from each other and you would have to calculate the relief in times of falling prices, or the amount you add back in times of rising prices, on the difference to the amortisation quota for the year which the change in prices since the loan was issued bears to the price at which the loan was issued. You can treat them as fixed capital, but it would be very much more complicated and I doubt very much whether it is practically necessary though logically correct.

2578. Mr. Kaldor: The case for this replacement cost basis in calculating adjustments in depreciation is, is it not, that at present the Government gives the tax allowance to the company in depreciated money?—No, I think it is not quite that. My main case really is that our present system tends to increase both an inflationary position and a disinflationary position; that the Government collects taxes which would otherwise have gone to increase business reserves. If you had this method of showing lower profits for all purposes in times of rising prices as at present, I think it is extremely unlikely any of the reduction in tax this would involve would be distributed in dividends. If anything, I think it would be the other way. Showing lower profits after an adjustment would cause dividends to be lower rather than higher so that reserves would increase not only by the reduction in taxation but also possibly by some reduction in dividends and you would get a net increase in saving, whereas at present the whole, or more than the whole, of the extra tax the Government gets owing to this method of calculation ought to be put to a Government surplus and if the Government does not put it to a surplus then there is a net increase in the inflationary position.

2579. Your position is that the Government raises too much tax in times of inflation and thereby makes the inflationary pressure worse than if it raised less tax?—It raises too much tax that come out of profits which would otherwise be saved. It very likely does not raise enough which would come out of consumption. If it raises a very large amount of taxes which reduce savings or mop up savings, unless it puts at least the excess in a Budget surplus without itself doing additional investment because of that Budget surplus, it will increase the inflationary position. It is reducing the amount of the national savings.

2580. You are assuming that when the Government raises less in profits taxes it replaces the lost revenue by some other form of taxation?—It does not need the revenue. What the Government wants the Budget surplus for is to equate the total national saving with the total

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[Continued]

national investment plan, which is based on the resources available in the investment goods industries. If the effect of less taxation is that business saves as much or more than the Government has lost, then the Government does not need to replace it by any other form of taxation, but can manage to run the country with a smaller Budget surplus.

2581. You say that to the extent business taxation is reduced, dividends will not be increased under this scheme and therefore the whole of the tax savings will be put in reserve and will not stimulate investment?—The Government having a Budget surplus stimulates Government investment.

2582. It is a very far reaching problem; I do not want to go too far.—I think it is true to say at present the total of investment is to a very considerable extent independent of the total of business savings unless the effect of the taxation is that the Government allows money altogether to become tighter and the rate of interest to go up; unless there is tighter money and a rise in the rate of interest then the amount of investment is not dependent on the amount saved by individual businesses.

2583. I am inclined to agree, but your argument cuts both ways. Other people have suggested to us this idea of replacement cost and depreciation but they have suggested it for the opposite reason, viz. that businesses are not in a position to replace items of equipment that wear out, they are financially not in a position, therefore they are to be given these tax reliefs to maintain the physical capital of the company intact. Now you are saying the amount of capital expenditure which they undertake is largely independent of business savings, and I agree with you.—I said assuming there is no rise in the rate of interest, but unless the Government saves the whole amount of the extra taxes that the businesses are paying out of reserves, or unless there is a rise in the rate of interest, there will be a gap which will take the form either of an adverse balance of payments, as it did last year, or of an increase in inflationary pressure and forced savings through some other channel.

2584. Your point is that the Government raises too much tax which is paid out of savings?—That is right.

2585. And does not reduce expenditure?—That is right.

2586. The Government does not have a corresponding Budget surplus to offset this?—Yes.

2587. And for various reasons are not likely to have?—Yes.

2588. Therefore if these taxes were not raised and the Government revenue was correspondingly lowered, as far as the general inflationary position is concerned it would not be worse and it would not be better?—I think there is something to be said for the view if the taxes were not raised the Government in showing a Budget surplus would not feel able to make certain expenditures which it now does on capital account.

2589. It is a means of forcing economy on the Government?—I would not say that necessarily. It may be the Government does set aside enough and does have a sufficiently large Budget surplus. That is an issue I do not wish to pre-judge; but assuming it does, the problem arises whether the Government will make use of this Budget surplus in the sort of way that will best enable the capital of the country to be maintained. The way it has been doing it in the last few years is that the Government has been paying off debt to the banks and businesses have been getting into debt with the banks. It would have been better if the businesses had kept the money themselves instead of giving it to the Government for the Government to repay to the banks to lend to the businesses.

2590. Your argument is a general argument for reducing taxation on business firms. It could be as well used for reducing E.P.L.?—For reducing those taxes on profits which by their nature are paid out of business savings. That might if you like apply to any tax on profits which does not in fact have the consequence of reducing dividends, and that does depend on the form of tax. In this particular one, if this system was adopted, the companies would have smaller profits for their own purposes as well as tax purposes, I should have thought it was unlikely they would have used the lower tax to increase dividends.

2591. Does it not follow from what you are saying, supposing you take the sum so be raised in taxation as given, whether right or wrong is another matter, but supposing you take it as given, the introduction of the replacement cost depreciation would be followed by a higher general rate of tax?—The whole essence of my argument is that the total of taxation must not be taken as given. We only need such a large Budget surplus because so much of the Government taxation is in fact paid for out of capital.

2592. You would agree it conduces to clarity of thinking to distinguish between these two things. Your answer to my question was that there is a strong case for reducing taxation, particularly taxation which comes out of savings of one sort or another, but the question at issue is one of adjusting the basis of taxation on the ground of equity. They are two entirely different matters?—Yes.

2593. When you come to this business, would you put your main reliance for this particular reform on the matter of savings; in other words, there is too much tax on savings?—May I quote the last sentence of paragraph 1:

"I consider it would be most desirable to relieve the Government of this responsibility for providing a compensating mechanism to obviate the distorting effect on the economy of our present methods of estimating profits."

That is to say, that with our present method the Government has to run a large Budget surplus in times of rising prices and inflation unless it is to intensify the inflation and it ought to run a large Budget deficit in times of falling prices unless the effect of this method is to intensify the depression. I think it would be much better if you could relieve the Government of that responsibility for having to offset a distortion of the system which is quite unnecessary.

2594. On this issue do you regard stocks as not so important? The trouble is that businesses over-estimate their profits on rising prices and under-estimate their profits in times of falling prices?—Yes.

2595. Is the most important correction to be made here a new method of accounting in stock valuation?—I think I was suggesting one, or a modification of the method, but as to the importance, the impact effect of a single sharp rise in prices is greatest on stocks, but the effect is temporary, while that on fixed capital may go on for years. One has a sudden immediate effect, the other a much less immediate effect, but a long term one. I think it can be said that in 1929-30 the apparent difference between something like this method and the actual method ran into £200 or £300 million. At a time when most businesses thought they were losing money heavily, in fact on a basis of real money they were making probably larger profits than they had made at any time. The psychological effect of that is extremely important. I think it is even more important in times of falling prices than in times of rising prices. Businesses may be aware of the danger of paying away their profits in rising prices, but in times of falling prices they set aside money they cannot spend on replacement, they do not distribute it as dividends, they do not have to pay it in taxes and they do not want to expand their business. The result is that businesses still doing well tend to accumulate large amounts of idle cash and thereby intensify the depression. It causes you to set aside in a period of falling prices money which you cannot do anything with except pay debts.

2596. In times of rising prices, as they are now, companies may set aside something called "increased replacement cost" on fixed assets, whether it comes out of taxed profits or untaxed profits does not matter very much, but in times of falling prices they do not automatically draw on these reserves as they would under a more automatic system of accounting?—Yes.

2597. I am inclined to agree with that, but I would suggest that it is an accounting reform and not a tax reform?—Yes, but I think the tax reform would follow the accounting reform. If the Treasury accepted a revision of the present method of accounting that would be the effect of it.

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[Continued]

2598. Suppose you say that there is too much tax on profits because it largely comes out of savings, and the Government does not adequately put it into a surplus so that it increases inflationary pressure. Let us take that case. Where would you put the reduction, so to speak? Would you think anything of the argument that if you are to reduce taxes on profits it is better to reduce taxes on the margin? Any tax concession by way of replacement cost leaves the marginal rate of taxation unaffected. It is like giving an increase in flat rate personal allowances which has no conceivable effect on behaviour?—I think its chief effect is on the capital market; it means instead of businesses having to go into the capital market, they will not need to.

2599. Now you are talking of another point. They need money in order to spend money?—Where they are either having to expend or even, in extreme cases, and I believe this was so last year, where they have to go out into the market in some way to borrow money even to preserve their business physically intact.

2600. They borrow money because they need it for expenditure of some sort?—Yes, probably in the case of last year to maintain their inventories in face of rapidly rising prices. I think there is an extremely close association between the fact that we do our accounts this way, and the way we fix prices. Very often our businesses are obliged to charge on the basis of historical cost. We did in fact have to draw in £500 millions of capital from abroad in the form of adverse balances to fill up the gap last year. The total of savings including business savings was not enough by £500 millions to pay for our investment in business. I think if you had different accounting methods, prices would have risen more sharply in this country and consumption would have been lower. The effect is greatly to intensify, it is rather odd the point, if you base your selling price on the historical cost of the exact ingredients you happen to put in what you are selling. . . .

2601. Now you are back on your first point. Your first point was profits are exaggerated in times of boom?—Yes.

2602. And that leads to excessive spending. The second and opposite point is that owing to excessive taxation companies are limited in the amount they can spend and they have to go to the market to try to get it.—They are not limited in the amount they can spend so long as you do not restrict the amount they can borrow. As soon as you restrict the amount they can borrow then you come on to rising interest rates and tight money and you get less investment.

2603. Would you agree that from the second point of view, namely the maintenance of real capital intact (capital erosion that we hear so much about) that initial allowances are as good as anything else if you want to help business?—I think I am right in saying the initial allowances are a much greater help to people who are expending than to people who are maintaining their businesses. The people who really benefit from initial allowances are those who are expending their businesses; it is a subsidy on capital extension.

2604. Is it not capital expenditure?—With two companies with the same amount of capital, one of which is expanding rapidly and the other maintaining its capital intact. It is the one that is expanding that is receiving the greater degree of subsidy.

2605. I still feel they are two contrary arguments.—What I am saying is you are having too little saving and if you have too little saving either it will prevent you from maintaining your capital intact or it will develop inflation or it will develop an import surplus. What I am saying is this method causes you to have too little saving. That is the crux of it.

2606. Any other way of increasing saving would, from that point of view, be just as good?—Not necessarily just as good. I think on the whole I would rather see the savings in the hands of the businesses than in the hands of the Government. I do not believe it is easy for Government to get back its savings into risk investment.

2607. You might increase business savings, in other words, by reducing taxation?—You would not always have to reduce it. You must have it switching backwards and forwards between the boom and the slump. It is not a question that business taxation is always too high, that

is a separate question, but given any level of rates, it is too low in the boom and too high in the slump. That is apart from the question of rate.

2608. Mrs. Anney: Just one question, your method of re-calculating or making adjustments for price changes would obviously affect different industries in different ways. Different types of industries, according to their particular structures or according to the price changes of the plant which they have to replace?—They would all use a common index; there would be one for the whole country.

2609. I would ask whether in your view that is a desirable or undesirable thing, and if you consider it desirable that some types of industries should be assisted more than others why is that so?—I do not think it would be types. I think it would depend very much more on capital structures. At present the industry is hardest hit which has the least debt, and the present system of calculation is to some extent, I do not think it is a subsidy, but it is a great reduction in the burden if you are heavily in debt. I do not consider it necessarily a good thing to subsidise that as against equity financing, but of two companies at present, one of which is financed mainly by debenture and preference shares and the other by equities and which have the same asset structures, the one with the equity capital is much more hardly hit than the company with the large amount of fixed capital.

2610. I was also thinking of the use of a general index instead of re-calculating the replacement value of particular assets. That also would be affected according to the relative position of different firms?—Yes. I have tried to say that to do it on the actual cost of the thing which each industry uses would be giving an undue benefit to those whose assets have risen much more than other people's assets because if you have a stock of assets of which the value has risen unduly you are in a better position than anybody coming fresh into the industry or anybody expanding. I have taken the case, to make it simple, where you have a constant general level of prices; for variations in particular prices I would claim that under those conditions the people whose assets have risen in price are really better off and those whose assets have fallen in price are worse off where the value of money is constant. I admit that my calculations for changes in the general purchasing power of money are extremely rough, but I would say that almost any rough approximation you can do would be infinitely better than we are doing at present and nobody within a very wide limit can say it is wrong. There are a considerable number of indexes, any of which I think would be better than the present position.

2611. Mr. Crick: I want if I can to refresh my memory with your help. Referring to the statement at the beginning of your paragraph 2 I was not clear whether that sentence was intended as an historically accurate statement of the express purpose of the initial allowances or whether as your interpretation of the broad aim that the kind of adjustment had in mind?—I am afraid I was using it there, perhaps it was the wrong word, not as purpose but as effect; that the effect of this was in fact to do this rather than the intention with which it was brought in. The Government granted it and it was an effect is what I was trying to say.

2612. The intention, as I recall it, was to stimulate industrial re-equipment?—I think it was, which is a very different thing.

2613. Would you agree that a time of rising prices is the very worst time at which to introduce or enlarge initial allowances, and that a time of falling prices is the very worst time at which to reduce or remove them, from the point of view of stabilisation?—The first point I would certainly agree because I have thought of it. The second point I have not thought of, but I imagine *per contra* it is true. What you need to do in times of falling prices is to stimulate investment; in times of rising prices you do not need to do it. If you have an inflationary position excessive investment is probably the main cause. Investment is excessive, in this sense, in relation to savings and it may be that for other reasons the Government holds investment ought to be larger than existing savings, but in that case it should not simply allow the savings to be forced out by inflation, but it should take particular steps to generate savings by some direct restriction of consumption. I think there was a case after the war for saying savings were low largely as the result of the gross redistribution of income, partly also to wartime shortages, and investment was urgent. We could probably have

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[Continued]

stimulated saving to some extent by very high rates of interest, though that is perhaps doubtful. If it is Government policy that investment should take place ahead of voluntary saving it is open to the Government to force the saving in some way, except by inflation which is a very bad way of doing it. With that gloss I would accept your statement.

2614. This is a very broad question arising out of it, and you may prefer not to answer it at this stage, but if you are prepared to answer it, so much the better. Do you, by and large, regard taxation as applied to incomes and profits as a suitable instrument of economic policy?—I think there is no doubt that I prefer it as an instrument of economic policy to direct controls. I was thinking of indirect taxation particularly. I think if you wish to reduce drunkenness you will probably do it much better by a high tax on liquor than by prohibition. In that sense I would regard it as preferable to certain other instruments of policy.

2615. These you are speaking of moral or social policy rather than economic.—I am sorry.

2616. I was thinking of broad economic policy.—Most taxation is moral or social.

2617. I am not concerned with that at the moment. I am thinking purely of economic policy, monetary policy, stabilisation policy and so forth?—I think that very high and progressive rates of direct taxation have extremely harmful effects, high and progressive. I do not think moderate rates do very much harm even though highly progressive, and strictly on the economic, as apart from the social aspect, I think high rates probably do not do much harm if they are not steeply progressive. In fact I gather one of the ways they get backward races to work is by imposing poll taxes. I presume if they get them to work one would regard it from the point of view of the Government as economically beneficial, but I would agree where rates of direct taxation are both very high and highly progressive they can have most harmful results. I think the problem is not so much the form of taxation as the whole level, which again depends on policy on the expenditure side. I do not think you can reasonably hope to raise a very much larger proportion of our present taxes by indirect methods and I think the others are a highly regrettable necessity due to the total level of expenditure. The only way out that I see is somehow or other to get down the high level of Government expenditure.

2618. There are two small matters of detail which will not take a moment. Will you tell us how you compiled your general price index and what is included in it?—All I did there was this, I had for another purpose made a rough index of capital goods prices and I simply combined them with the consumption index roughly in the proportion of the amount spent on the two.

2619. If you were setting about constructing an ideal index or the best index you could for this purpose, would you be inclined to include something for prices of land and buildings?—At the present moment I should have thought the prices of land were so extremely artificially bodivelled with all sorts of things and it would not be very useful. In a free land market I think I should.

2620. Would you include wages?—Wages I think appear in the other indexes.

2621. Now on this scheme of yours, and this is my last point, would you suggest that your method of computing profits should be optional or compulsory?—Compulsory.

2622. I was interested to notice that Professor Baxter, for instance, in working out the accounting side of this in his paper,* took the view that it should be optional. I wondered if you shared that view?—I do not suppose it would do much harm to make it optional if it were irrevocable. What is essential is that people should not be allowed to chop and change as convenient to them.

2623. On the whole, you would prefer that it should be compulsory?—I should like it to be universally acceptable, to be a universal system; that it should be the way people think and act, so that when people read a balance sheet they know it has been treated in this way and they know what it means.

2624. Mr. Carrington: Why do you bring preference capital into this adjustment; it is referred to in paras. 16 and 17.—Because as between two companies, one of which is wholly equity and one of which has preference capital, rises in prices are beneficial to the fixed-interest capital company. They are getting a real benefit from the reduction.

2625. Relief from the burden of what?—In the debt. It is a contingency debt; the repayment of preference capital is a contingency debt.

2626. Why do you suggest it would be repaid except in the case of redeemable preference shares?—Except in the case of liquidation.

2627. It is irredeemable if you take the conception that the business is permanent; unless you have redeemable preference shares I would suggest the preference share is there for all time.—One used to think so. There have been one or two cases recently which make one doubtful. Even an irredeemable preference share has been got rid of recently under the plea of reduction of capital, but I would agree a preferable method of dealing with liabilities would be to regard them as fixed capital in which case an irredeemable preference share as an irredeemable debenture would be equivalent to fixed capital on which no depreciation is allowed. I think it would be perfectly possible to adopt the same system though it would make it much more complicated.

2628. In other words, you would deduct your irredeemable debentures or your irredeemable preference shares from your fixed assets before arriving at the figure upon which you are to make your calculation?—I would not deduct them from the fixed assets. There are two types of fixed assets on one of which depreciation is not allowed, and on the other of which depreciation is allowed. To be strictly logical, though it would be very complicated, one could regard one's irredeemable debentures and one's irredeemable preference shares as negative permanent capital, that is to say, capital of the sort on which no depreciation is allowed, whereas your redeemable liabilities, long term loans and redeemable preference shares, would be negative fixed assets on which depreciation is allowed. I did consider working out a system on that, but it became so complicated in the actual working I thought for the purpose of the exposition I had better put it in a simpler way.

2629. I cannot see the logic of classing irredeemable preference shares and long term debts together.—I think irredeemable preference shares are exactly parallel to irredeemable debentures, a few of which are about, in neither of which you pay off the capital, in neither case is the burden reduced by the rise in prices.

2630. Sir Geoffrey Heyworth: One further point arising out of what Mr. Carrington has put to you, you agree that on a preference share the rate of interest is conditioned by the fact that there may be a risk of capital loss?—Certainly.

2631. And, because of that, is this basis of re-valuation entirely fair?—I think so because, the interest rate having been higher for a redeemable preference share the ratio of capital to the interest is lower.

2632. You may take it the great bulk of preference shares are not redeemable.—I quite agree. I think strictly logically it would be possible to work out a system whereby irredeemable preference shares and irredeemable debentures would be excluded and you would use as an annual quota, a kind of negative depreciation, the amount necessary to amortise redeemable fixed interest securities at maturity.

2633. How do you fix the date for amortisation if it is really indefinite?—There is no amortisation for irredeemable. If redeemable at a fixed date—I am not sure what the legal position of a redeemable preference share is, whether when mature it is a debt or not. If the contract is you will repay it at maturity I should have thought there was a strong case for saying it is a kind of debt. I think for economic purposes I should regard it as a debt maturing on that date.

Chairman: Thank you very much for your illuminating evidence.

The witness withdrew.

* Not reproduced in these Minutes of Evidence.

MINUTES OF EVIDENCE **10**
TAKEN BEFORE THE
ROYAL COMMISSION ON
THE TAXATION OF
PROFITS AND INCOME

TENTH DAY

Monday, 16th June, 1952

WITNESSES

MR. C. J. GEDDES, C.B.E.
MR. D. BOWERS
MR. L. MURRAY
MR. F. JONES

} Trades Union
Congress

Questions 2634-2800



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TERMS OF REFERENCE
(As amended 11th March, 1952)

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages; to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer; to consider the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden fairly among the individual members of the community; to make recommendations bearing in mind that in the present financial situation it may be necessary to maintain the revenue from profits and income; and, in so far as they make recommendations which would on balance entail a substantial loss of revenue, to indicate an order of priority in which such recommendations should be taken into consideration."

NOTE

For the guidance of intending witnesses the Commission published a list of the main heads under which evidence was invited. They explained that the list was not necessarily exhaustive and that witnesses could put in evidence on questions not specifically mentioned, provided that they fell within the Commission's terms of reference. The list is reproduced below.

A. General social and economic questions

1. Is the present system of taxation satisfactory, or could it be improved, in relation to:—
 - (a) incentives,
 - (b) risk bearing,
 - (c) encouraging savings,
 - (d) the control of inflationary or deflationary tendencies,
 - (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment,
 - (f) its effect on the distribution of personal incomes,
 - (g) other economic and social objectives?

These questions can be considered in relation to the taxation of:—

- (i) salaries and wages (P.A.Y.E.),
 - (ii) profits of businesses and self-employments,
 - (iii) dividends and other sources of income.
2. Would it be advantageous to link Income Tax with social security payments and contributions?
3. Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

B. Particular matters

4. Is the taxation net drawn too widely or too narrowly in relation to:—
 - (a) the taxation of United Kingdom residents (companies or individuals) on overseas profits,
 - (b) the taxation of non-residents on United Kingdom profits,
 - (c) the definition of residence, etc.?
5. (a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particulars—
 - (b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?
6. Is the basis of computing income from property under Schedules A and B satisfactory?
7. Should the present rules about deductions for outgoings and expenses be altered?
8. Are the provisions for relief in respect of double taxation satisfactory?
9. Should the present system of graduation by means of the exemption limit, personal allowances, reduced rate relief and Surtax be altered?
10. Should the existing differentiation between earned and unearned income be extended or reduced?
11. Are alterations necessary in the rules governing personal and other allowances?
12. Should the rules about the taxation of husband and wife be altered (a) as regards aggregation; (b) in any other respect?
13. Should P.A.Y.E. be altered or abolished?
14. Should the principle of deduction at source be extended or restricted?
15. Should the method of assessment to Surtax be altered, and in particular should it be deducted from salaries?
16. Are any alterations desirable in the system of administration and the functions of the various statutory bodies or persons connected with taxation?
17. Are any changes in the provisions against avoidance and evasion desirable?
18. Is any alteration necessary in the rules governing the taxation treatment of special classes of taxpayers (e.g., public corporations, co-operative societies, charities)?

MINUTES OF EVIDENCE TAKEN BEFORE THE ROYAL COMMISSION ON THE TAXATION OF PROFITS AND INCOME

TENTH DAY

Monday, 16th June, 1952

PRESENT:

THE RT. HON. LORD RADCLIFFE G.B.E. (*Chairman*)

MR. H. L. BULLOCK
MR. W. S. CARRINGTON, F.C.A.
MR. W. F. CROCK
MR. J. E. GREENWOOD
MR. GEORGE HAYWOOD
PROFESSOR J. R. HICKS, F.R.S.
MR. N. KALDOR

MR. W. J. KIRKICK
MISS L. S. SUTHERLAND, C.B.E.
MR. J. MILLARD TUCKER, Q.C.
MR. G. WOODCOCK
MR. E. R. BROOKES (*Secretary*)
MR. D. G. DAYMOND (*Assistant Secretary*)

MR. C. J. GEDDIS, C.B.E., MR. D. BOWERS, MR. L. MURRAY and MR. F. JONES, on behalf of the Trades Union Congress; called and examined.

MEMORANDUM SUBMITTED BY THE TRADES UNION CONGRESS

A. GENERAL SOCIAL AND ECONOMIC QUESTIONS

INTRODUCTION

1. The Trades Union Congress is the central body representative of the overwhelming majority of British trade unionists. Affiliated to it are 187 trade unions with a total membership of nearly eight million workpeople in almost every branch of industry and commerce. In its representative capacity the Trades Union Congress, through its General Council, is regarded by Governments, by central employers' associations and by other national and international organisations as the only body competent to speak on behalf of British workers as a whole.

2. We wish at the outset to make it clear—although this is outside the Royal Commission's terms of reference—that, while we recognise that indirect taxation will always have a place in a flexible tax structure, we consider that direct taxation is generally more equitable than indirect taxation, which is often regressive. It is in many ways unfortunate that the operation of indirect taxation is not included in the present enquiry, since we consider this subject is directly relevant to many of the questions under review and that it would be undesirable to formulate long-term principles for direct taxation on the assumption that either the amount or the proportion of tax revenue contributed by indirect taxation is to remain substantially unchanged.

3. Workers in general, and particularly those earning comparatively low incomes, have today a greater interest in taxation than ever before, not only because more pay income tax now but also because the spending of the revenue derived from taxation has a major influence on their standard of living. In this evidence we give particular attention to the effects of direct taxation on working people, although we do not restrict our observations to this narrower field and are prepared, should the Commission so wish, to submit a supplementary statement on particular aspects which are not considered in this document but on which the Commission might wish to have our written views.

4. Although it is not the duty of the Royal Commission to enquire into the expenditure of the revenue derived from taxation they will appreciate that the raising of revenue on the one hand cannot be considered in isolation from the extent, purpose and direction of Government expenditure on the other. In an economic system such as our own, where the Government has assumed and is assuming growing responsibilities for national welfare, taxation necessarily becomes one of the main methods by which the Government influences the nation's economic activity.

5. The primary object of fiscal policy should be the maintenance of full employment at rising standards of living. The level of employment can be influenced not only by alterations in the scale and distribution of Government expenditure but also by changes in the methods of raising revenue. Other objects of taxation policy, important in themselves but subsidiary and contributory to the maintenance of full employment, are social reform, income redistribution and the stimulation of productive efficiency.

6. Given these objects of taxation policy there are three main tests by which the desirability of taxes should be measured. The first is whether particular taxes serve definite economic or social purposes which accord with the public interest. The second is whether taxpayers can understand the taxes they are required to pay and can see that these taxes are administered equitably. The third is whether the tax structure as a whole is adaptable to changing industrial and economic conditions: the more that the Government intervenes in the economic and industrial life of the nation the greater is the need for flexibility but the greater is the danger of rigidity.

7. We consider that it is of the first importance that long-term taxation problems should not be confused with those problems which derive from present economic circumstances. A prominent feature—so far as internal economic conditions are concerned—of the last ten years has been a steadily rising price level and a constant threat of inflation. Whether or not rising prices are inseparable from full employment it is clear that international factors have played a big part in the price trends of the last decade, and it would be unrealistic to make fundamental changes in the tax structure merely to meet what may prove to have been abnormal conditions.

INCENTIVES

General effects of P.A.Y.E.

8. It is sometimes alleged that P.A.Y.E. reduces the incentive to increased productive effort in three main ways. First, because the rate of tax levied on overtime earnings is often higher than the rate levied on normal time earnings, overtime becomes less attractive; in some cases workers may receive not less than their plain time rate when they work overtime for which plus rates are commonly paid. Second, P.A.Y.E. deductions are related to and fluctuate with earnings week by week: this serves as a direct reminder to workers that if they increase their earnings in any week they will pay more in tax on the next pay day. Third, the fact that, during periods of unemployment, they can obtain refunds of income tax encourages workers to take time off and contributes to

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abstemiousness and "unofficial" strikes. These alleged defects derive from the principles of P.A.Y.E.—namely that it is a progressive tax and that it is an annual tax collected in instalments from current earnings.

9. There can be no doubt that there is some truth in these allegations, but we are of the opinion that the disincentive effects of the operation of P.A.Y.E. have been exaggerated. There is very little detailed evidence about the effects of P.A.Y.E. as such on incentives and production, and certainly not enough to justify dogmatic generalisations. It would, of course, on the other hand be fallacious to argue that it is a general rule that higher taxes stimulate individuals to work harder so as to increase their net earnings, although in some instances this is true particularly where individuals are seeking to maintain an accustomed standard of life. All that can justifiably be claimed is that most individuals reach a certain point where their extra earnings net of tax are not sufficient to counterbalance the attractiveness of more leisure. This point varies, and we can submit no evidence to show conclusively that the operation of P.A.Y.E., as a system, in general discourages the working of overtime, or the introduction of schemes for payment by results. This is not to deny that cases do occur, and we discuss in paragraph 15 what can be done to eliminate this.

10. It is, in any event, impossible to say whether such disincentive effects as may occur result from the method of operation of P.A.Y.E. or from the prevailing high level of the income tax. High prices and shortages of consumer goods have also played a part. We are of the opinion that these factors are often confused by taxpayers and that P.A.Y.E. is often unnecessarily blamed. More should be done to let taxpayers know exactly how P.A.Y.E. works and how it affects them. This might be done, for example, by sound and television broadcasts and by suitable posters for exhibition on notice boards and in canteens of factories and workshops.

11. There is the further consideration that disincentive effects are likely to be strongest during a period when the general level of taxation is shifting upwards—as, for example, between 1939 and 1946 when the standard rate increased from 7s. 6d. to 10s. 6d. and most allowances were reduced. When the general level of taxation is falling there are likely to be less complaints about the operation of P.A.Y.E.: if it were stabilised—even at a comparatively high level—it is probable that wages and standards of living would move or less adjust themselves to what became the "accepted" tax level, and that disincentives would be less keenly felt.

Discouragement of overtime etc. working

12. As P.A.Y.E. is a progressive tax the average rate of tax on the income as a whole will be smaller than the marginal rate on the last slice of income: net receipts derived from each pound of extra earnings will therefore constantly tend to diminish. This, of course, is not a peculiarity of P.A.Y.E.: it is common to all taxes which fall with increasing weight on successive slices of income. It has, however, given rise to the complaint that, by taxing extra earnings at a marginal rate, P.A.Y.E. discourages overtime work and extra exertion where payment is linked to results. We have already given it as our opinion that these complaints are, to a large extent, misdirected. However, even if this is so, until people can be shown where they are wrong these complaints will persist, and will probably continue to be accompanied by the demand that "extra" earnings should receive some tax relief.

13. We are unable to recommend that such relief should be granted. To put it into effect it would be necessary to devise machinery which could identify the income attributable to the extra hours worked or to the extra exertion, and this would require a recognised norm of hours or intensity of effort beyond which the relief would operate. Normal hours, however, are usually determined by voluntary negotiation, and vary considerably from industry to industry and even from one occupation to another within industries. They can be and are often changed. In such conditions agreement with the Inland Revenue on a normal period beyond which earnings would rank for taxation at a reduced rate would present a formidable administrative problem. Similar considerations apply to intensity of effort, which is at least as important as the time spent at work, and it would be necessary to devise some method

of identifying increased effort on piecework and, indeed, on time work. If relief was not applied to piecework it would militate against the extension of schemes for payment by results—which are in general desirable—and would put a premium on extended hours of work including Sunday working.

14. It is quite possible that, even if difficulties of definition could be overcome, there would be a danger of collusion between some employers and some workers to avoid tax unless the Inland Revenue maintained a close administrative control, which would mean considerably extra work. Such a scheme, moreover, would probably make existing industrial agreements more rigid and less adaptable to changing production needs. It is also possible that one of the results of the introduction of such a scheme would be to diminish the importance of wage-bargaining between employers and employed, leading in many instances to their joining forces to bargain with the Inland Revenue on the extent of the relief. This, we consider, would be undesirable from the point of view both of workpeople and of the Inland Revenue.

Graduation

15. We consider that there is a case for modifying the present structure of the income tax to reduce the distance between the tax steps which result from the operation of the various allowances. The divergence between average and marginal rates which is inherent in any progressive tax could only be eliminated completely by levying a flat rate of tax on every pound of income and, for reasons which we give in paragraphs 75-6 we do not consider that this is desirable. It would, however, be beneficial, while maintaining the general structure of P.A.Y.E., to increase the number of steps between the point where the individual becomes liable to tax and the point where he begins to pay at the standard rate. The precise number of steps will depend on the level of the standard rate, and no hard and fast rule can be laid down, but we consider that at the present time, while the standard rate is 9s. 6d. in the pound, the number of steps should be increased by charging at least three reduced rates. In present circumstances these might be 3s. 6d., 5s. 6d. and 7s. 6d. on the first £100, the next £100 and the next £50 respectively. This should be a minimum and, if administratively practicable, the number of steps should be more than this.

Effect of weekly assessment

16. The peculiarity of P.A.Y.E. really lies in that, while income tax is assessed on the annual income, the system of weekly deductions causes the impact of the tax to fall unevenly on each weekly part of that annual income unless each week's income is equal. Before P.A.Y.E. was introduced in 1944 income tax assessments of wage-earners were made twice yearly, and the tax was collected about 10 months after the assessed wages had been received. This involved the deduction from current wages of an amount of tax computed by reference to wages earned many months previously. From the incentive point of view this system was preferable to P.A.Y.E., since extra earnings did not immediately attract extra tax. We do not, however, consider that it would be desirable to revert to this system or to a variant embodying the principle of assessment in arrears (as, e.g., making the rate of tax deduction in any year depend on the previous year's ascertained income and current allowances).

17. Wages fluctuate from year to year and in many cases from week to week: the wage bill of all manufacturing industries in 1949* varied from £485 millions in the first quarter to £495 millions in the second quarter; to £501 million in the third quarter; and to £505 millions in the fourth quarter. Fluctuations in 1948 were even more pronounced, as were fluctuations in individual industries such as building and contracting which are affected by seasonal factors. Any departure from current calculation of tax accentuates what are often fortuitous factors, and particularly where wages fall or fluctuate, can cause hardship by calling for high tax payments at the time when the individual is least able to pay. It may be argued that a cautious and prudent wage-earner would set aside a portion of his earnings to meet future tax liabilities: but apart from the fact that it is difficult at the best of times to estimate future probabilities, such action might re-

* White Paper: National Income and Expenditure of the United Kingdom 1949-9, p. 11 (Cd. 7933/1950). No comparable figures have been published for 1950.

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introduce the disincentive which the proposal is designed to eliminate. A further consideration is the accentuation of inflationary and deflationary tendencies referred to in paragraph 56 below.

18. Nor are we in favour of suggestions which have been put forward for a weekly wages tax, whereby each week would be treated as a complete operation and the taxpayer's liabilities would take no account of the earnings or tax during the portion of the year already completed. Whatever the period of assessment—and we see no reason to recommend the adoption of a period other than a year—it should be a principle that the same total of tax should be levied no matter in how many instalments the earnings are paid. On the contrary, if a weekly wages tax of this nature were imposed there would be many instances where the total tax paid over the year would be larger or smaller than the liability as computed on an annual basis: this would be a haphazard method of spreading the tax burden, and would do more than anything else to destroy the general confidence of wage-earners in the equitable administration of the tax system.

19. A subsidiary effect would be to abolish the system of tax refunds during periods of unemployment. We do not consider that their abolition would, on the whole, be desirable. There are certainly individuals who have abused this right by taking time off without good reason in the knowledge that they could for a time support themselves on tax refunds. We believe, however, that the prevalence of this abuse has been exaggerated, and that the social advantage of having this extra money available at times of emergency such as sickness and temporary unemployment far outweighs the harm done by the minority.

Conclusions regarding Incentives

20. We are of the opinion that the disincentive effects of P.A.Y.E. are not such as to justify the introduction of special rates of tax for income derived from overtime and extra effort. We consider that there is a case for a smoother graduation of taxation up to the point at which the standard rate applies, and that more should be done to let taxpayers know how P.A.Y.E. works and how it affects them.

RISK-BEARING

21. Risk capital has traditionally been provided out of the savings of individuals with high incomes and, since the establishment of the joint-stock company, out of corporate savings. As the importance of company reserves as a source of capital for new projects has grown, so the relative importance of voluntary risk-bearing by individuals has tended to diminish.

Effect on risk-investments

22. The complaint is often made that the present system of taxation, by reducing the margin left to persons on high incomes after satisfying consumption, reduces their willingness and their ability to lead capital at risk. Moreover high taxation, it is alleged, reduces the attractiveness of the return on risk capital and may also lead investors to draw on their capital to maintain their accustomed standards of living. We do not doubt that, other things being equal, these allegations are broadly correct, although in some cases high taxation may lead investors to speculate for higher returns or capital appreciation in order to maintain their standard of living. However other things are, as usual, not equal and we do not accept the extension of these allegations, that industry will stagnate because the stimulus to undertake new and venturesome projects is thereby diminished.

Full employment

23. Our main reason for not accepting this implication is that it does not take into account the other factors determining the general level of economic activity. As we have already pointed out, the raising of revenue and the spending of that revenue are two aspects of the same process, and, in so far as money is taken in taxes and laid out by the Government to maintain full employment, the risk which attends investment—or at least that part of the risk which is due to general economic fluctuations—is reduced.

24. This is reflected to some extent in Table I, which has been extracted from the General Annual Reports on Companies issued by the Board of Trade, and which shows the proportion of public and private companies (in England and Wales) going into liquidation in each of the years 1930-38 and 1946-49:

TABLE I

Year (i)	Companies having a share capital on the Registers (ii)	Liquidation begun (iii)	Percentage Co. (ii) of Co. (i) (iv)
1930 ...	104,386	3,111	3.0
1931 ...	106,614	3,194	3.0
1932 ...	111,165	3,063	2.8
1933 ...	116,238	2,947	2.5
1934 ...	122,089	2,901	2.4
1935 ...	128,737	3,064	2.4
1936 ...	136,510	2,996	2.2
1937 ...	142,821	2,993	2.1
1938 ...	147,881	3,175	2.1
1946 ...	201,446	1,830	0.9
1947 ...	218,339	2,402	1.1
1948 ...	224,596	2,615	1.2
1949 ...	229,483	3,109	1.4

25. The war years are excluded from the above Table because of the abnormal conditions then prevailing. The years 1948 and 1949 are also to some extent abnormal since they include some companies wound up on transfer of certain industries to public ownership. However, even taking the figures as they stand, it is apparent that in recent years of full employment the risk of carrying on business has been much smaller than it was even in the relatively good years 1935-38 when the worst of the depression was over.

26. Nor has there recently been any indication of marked unwillingness on the part of private investors to provide capital for enterprise. Company issues have been buoyant in many cases being oversubscribed. Moreover, there has been no general evidence of a desire to purchase the safer rather than the more risky industrial shares. Table II, based on records of company issues offered direct to the public (compiled by *The Economist*) shows the types of shares, by percentages, issued by companies in the years 1932-38 and 1946-50 and in the first quarter of 1951:

TABLE II

Year	Percentage of all issues		
	Ordinary	Preference	Debentures
	Per cent.	Per cent.	Per cent.
1932 ...	31	16	46
1933 ...	25	12	43
1934 ...	35	27	18
1935 ...	39	34	27
1936 ...	62	21	17
1937 ...	63	19	18
1938 ...	53	18	29
1946 ...	75	17	8
1947 ...	82	22	16
1948 ...	75	17	8
1949 ...	63	27	10
1950 ...	44	8	43
1951* ...	60	24	16

There is no indication from these figures that investors are less willing to take up Ordinary shares than they were before the war. The increase in the proportion of company issues taking the form of debentures in 1950 does not, taken in isolation, prove that there is a lack of willingness on the part of investors to take up Ordinary shares: it is more probably due to the special requirements of the firms concerned.

Investment of small savings

27. One factor, which is discussed in more detail in the following section on Savings, should be mentioned here. Insofar as high taxation, particularly of large incomes,

* First quarter.

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leads to a redistribution of wealth by Government subventions, persons in lower income groups will have a greater opportunity of saving. It is not likely that a large proportion of these new savings will be invested at risk: the greater part will probably be consumed or invested in safe stocks. The net effect of redistribution will therefore probably be to diminish the amount of money available for risky investments.

Desirability of risk-bearing

28. Nevertheless, our general argument is that there is little evidence that the prevailing system of taxation has reduced willingness to invest in new projects and developments. In any event, risk-bearing is not desirable for its own sake; very few people would welcome the return of "bucket-shop" issues, and greater selectivity on the part of the potential investor has its obvious advantages. Nor should it be too readily assumed that risky investments, even if they bear fruit, are necessarily desirable investments from the point of view of the community.

The role of the Government

29. However, we recognise that it is possible that continuing high taxation will reduce the proportionate amount of savings forthcoming from private individuals and companies for risk investment. The question therefore arises as to how the gap is to be filled. We consider that the Government itself has a part to play in providing finance directly or indirectly for projects involving risk. Such intervention can be justified on the grounds of past experience and current activities.

30. In the inter-war years the workpeople in the coal-mining and cotton industries, to take only two examples, were not the only ones to suffer from the unwillingness of private investors to assume responsibility for providing capital for new projects—even when taxation was at a much lower level. It is now generally admitted that the projects would have been and still are desirable, and since 1945 the Government has had to take special steps to make finance available to these industries.

31. The Government has by its current activities shown that it is able and willing to undertake risks formerly reserved to private investors. Examples are the work of the National Research Development Corporation, the Export Credits Guarantee Department and the provision of finance for capital development by the National Coal Board. Another way in which the Government can and should help, where appropriate, is by granting special tax relief in approved cases of industrial development (as under the Cotton-spinning Re-equipment Subsidy Act) and on income specifically devoted to research projects (as through the Industrial Research Associations). This would provide a greater assurance than would, e.g., an indiscriminate reduction of the Profits Tax, that tax reliefs would be most usefully applied.

Conclusions as regards risk-bearing

32. Other things being equal, a high and progressive rate of taxation will reduce the willingness and ability of individuals and corporations to invest at risk, but the use of the resulting revenue by the Government to promote full employment and the consequent reduction in the riskiness of investment generally must also be taken into account. The available evidence does not suggest that there has yet been a marked shortage of risk capital for enterprise. We consider, however, that the Government can and should undertake to provide risk capital where necessary.

ENCOURAGEMENT OF SAVINGS

33. It is essential, in any consideration of present trends in savings, to draw a distinction between the effects of taxation and those of full employment and rising prices. It is also essential to distinguish between the system of taxation and the level of taxation. Obviously no precise estimate can be made of the relative effect of each of these factors on the ability and willingness to save of individuals or of the community, but the fact that current savings are affected not only by the progressive nature of our income tax but also by these other factors should constantly be borne in mind. The questions to be asked are, first, whether on balance the present system of taxation discourages or encourages savings by individuals and

companies; and second, if the main effect is discouragement, whether it is necessary or desirable to alter the present system of taxing incomes and profits. We are not in agreement with the suggestion sometimes put forward that, if taxation discourages private savings, it necessarily provides a case for reducing taxes; the latter may or may not follow from the former.

Saving by individuals

34. Income taxation is on the whole bound to reduce the willingness of individuals to save. Moreover as the present system of taxation is progressive it falls particularly heavily on the savings of people with high incomes, who are the traditional source of the bulk of individual savings. This may be offset in part by the redistributive effect of progressive taxation, particularly insofar as taxation is used to provide services, which otherwise people would have to pay for themselves. Where, however, taxation is generally high this may have the result only of increasing the relative amount of savings from low incomes, not the absolute amount. We believe that this is the situation at present and that the net result is to reduce savings by individuals.

35. Individual savings might be stimulated by a general reduction of taxation or by making the income tax structure less progressive. Both of these, however, would lead to a more unequal distribution of wealth than at present, and we do not consider that the encouragement of private saving would justify such a policy. Since, however, it is probable that most individual savings come out of large incomes derived from investments, and since company reserves consist of involuntary savings out of corporate income properly attributable to individuals, the level of individual savings will be influenced by the impact of taxation on company earnings, considered below.

Saving by companies

36. Provided that their prior charges are fairly stable, the reactions of companies to taxation will depend on how far they wish to maintain a real level of Ordinary Dividends. The evidence available suggests that industry as a whole has during recent years been more concerned to maintain and increase savings, where necessary at the expense of dividends. According to the White Paper on the National Income and Expenditure of the United Kingdom 1946-50* companies and public enterprises in 1950 made a net saving of £569 million, after providing for depreciation and taxation, compared with £172 million in 1938. In general we welcome this attitude, which ensures that company profits will be available to increase industrial efficiency. On the other hand it does not follow that all this money will in fact be invested in new plant and machinery; part will probably be needed to replace stocks at higher prices and some will be put to reserve to stabilise or increase dividends in the future.

37. We are of the opinion that the existence of differential rates of Profits Tax has done much to stimulate companies to make appropriations to reserve at the expense of distributed profits. In this way the present system has encouraged involuntary savings by industrial shareholders. This is a desirable trend, but we should point out that it can be carried too far: industry can save to excess. It is impossible to say whether the present level of savings is too high: many desirable investment projects have over the past few years been frustrated by shortages of materials and manpower. On the other hand conditions vary from firm to firm: some may have accumulated excessive savings and others insufficient. The point we would make here is that since the same tax rates apply to all firms, they cannot be regarded as the prime cause of insufficient savings on the part of particular firms—the real reason is probably inefficiency or imprudent distribution of profits. Whilst a general reduction of taxation might help some firms to increase their savings it would only help other firms to increase dividends.

Full employment and savings

38. The foregoing does not, in any case, take full account of the effect on savings of full employment. The level of savings—whether by firms or individuals—partly depends on the level of their incomes, and full employment by its nature generates additional personal and corporate incomes. Even if, therefore, the effect of taxation is to reduce willingness to save, the maintenance of a high and

* Cmd. 3203, Table 3A.

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stable level of employment by Government spending will increase the capacity both of individuals and of companies to save a progressively larger portion of their incomes.

Saving and investment

39. The proportion of income saved tends to increase at a faster rate than does the total income, but it does not automatically follow that investment increases at the same rate as savings. Mr. Colin Clark's^{*} National Income estimates suggest that, for example, although savings rose substantially between 1928 and 1930, the rate of investment actually declined during that period. The results of this decline in investment were reflected in the numbers of unemployed workpeople. Nor are total savings the only important factor: their distribution through industry will also affect the health of the economy. There can be no guarantee under a system of private financing that the available savings will flow into investment projects or that they will flow in the right direction. Market forces reflect the relative profitability of investments, but this may not always be the same as industrial or social needs. There is therefore no case for saying that unlimited stimulation of savings by individuals or companies is in all circumstances desirable.

Effects of Profits Tax

40. The main disincentive to saving by individuals lies in the progressive nature of the income tax and surtax. The taxation of corporate incomes is not progressive in the same sense. A company which, by efficiency or because of lack of competition, increases its profits does not thereby attract a significantly greater rate of tax. The main ways of encouraging company savings are, therefore, a general reduction in the level of taxation, or the abolition or modification of Profits Tax. We propose to deal here only with the Profits Tax.

41. The Profits Tax is commonly attacked on the grounds that as it is levied over and above income tax, on income of a particular kind it constitutes discrimination against business efficiency. There should, it is argued, be no tax on corporate income other than the general income tax. We do not share this point of view.

42. We do not oppose the abolition of the Profits Tax only because it would be difficult to raise from another source the revenue that would thereby be lost, important though this consideration is. Our support of the Profits Tax in principle is based mainly on the grounds that the community as a whole (through the Government) is entitled to share in the additional profits which accrue to companies in conditions of full employment. As we have already pointed out, full employment increases demand and reduces risk: thus the high profits earned in times of full employment cannot be regarded merely as the reward of efficiency and enterprise but as, at least in part, the result of expanding conditions not created by the business community.

43. Moreover, since under full employment prices and profits tend to rise faster than personal incomes, there is a strong case, in the interests of combating inflation, for levying a special tax on profits, whether distributed or not to reserve.

44. The arguments in the two last paragraphs can be tested by the movement of profits and personal incomes in the years of full employment since 1946.

TABLE III

Year	Corporate Profits ^(a)		Personal disposable incomes ^(b)	
	£ million	Percentage 1946 ... 190	£ million	Percentage 1946 ... 190
1946 ...	1,615	100	8,232	100
1947 ...	1,944	120	8,466	103
1948 ...	2,979	129	9,125	115
1949 ...	2,827	126	9,616	117
1950 ...	2,264	140	10,124	123

(a) Includes corporate trading profits and other corporate incomes.

(b) Excludes dividends and interest (included in (a)).

* Colin Clark: National Income and Outlay, Table 87, p. 190.
[†] Based on Tables 34 and 35, National Income and Expenditure of the United Kingdom 1946 to 1950 (Cmd. 8203).

The role of the Government

45. The corollary of the taxation of profits on a special basis is that the Government should be prepared, when circumstances justify it, to provide funds for private industry. The maintenance of full employment demands a different approach to the role of the Government as saver and investor. There is nothing sacrosanct about the proportion of savings previously contributed by public authorities, nor, we believe, is it sufficient for the Government to restrict itself to the part of residual saver. Its functions should rather be to stabilise the economy by surplus and deficit budgeting and to use its funds to stimulate not only general investment but also, where necessary, investment in particular industries and firms. Thus by feeding back to industry some of the funds it has taken in income tax and profits tax, the Government will be able, we hold, to ensure that profits are used where they are most vital to the economic health of the whole country.

Conclusions as regards the encouragement of savings

46. We are of the opinion that the present system of taxation reduces the willingness of individuals to save although, on balance, it may increase the willingness of corporations to save. The system of taxation, however, cannot be considered in isolation from the objects of taxation and the use to which the revenue is put. If the object is to maintain full employment, and if the revenue is used to this end, the resulting high level of economic activity will mean that earnings are likely to be higher and capacity to save will be increased. From a national point of view, if in this situation the capacity to save is higher but the willingness of individuals and corporations to save is not strong enough, then the Government should increase its own saving and investment. In particular, the special taxation of profits is justified in the interests both of equity and of combating inflation under conditions of full employment.

CONTROL OF INFLATIONARY OR DEFLATIONARY TENDENCIES

Taxation and Prices

47. The suggestion is often made that direct taxation is itself responsible for raising prices and that, therefore, the use of the tax instrument to combat inflation is to some extent self-defeating.

48. It is generally accepted that inflation is a rise in prices caused by purchasing power increasing faster than available goods. Direct taxation will therefore only stimulate inflation when both of the following conditions are fulfilled: (a) firms can pass on in their prices the burden of higher taxation to consumers and (b) those consumers are provoked to recoup themselves by increasing their spendable incomes. If condition (a) is not satisfied an increase in direct taxation will withdraw purchasing power from firms, and if condition (b) is not satisfied it will withdraw purchasing power from consumers; in either case, therefore, the tax increase will be deflationary.

49. As regards condition (a), the ability of firms to pass on direct taxes, in the form of higher prices, to consumers, is limited. It is true that where something like monopoly conditions prevail there will in theory be the power to do this, but in fact it is likely that even under such conditions an element of uncertainty about consumers' reactions will set a practical limit to the extent to which higher taxation is passed on. In the more usual conditions of industry, neither fully competitive nor fully monopolistic, it is probable that firms will be very cautious about increasing their selling-price without being certain that other firms will do the same—and in the case of an increase in direct taxation, whose effective burden per unit of output will vary with the financial structure and general circumstances and policy of each firm, it is by no means certain that all firms will react the same way. Moreover, all pricing policy is tentative, and it is almost impossible to make an accurate allowance for the effect of taxation upon gross profits at particular price levels: in any case it is, at the very least, doubtful whether any firm will aim at any particular figure of net profit, since calculations of this sort can so easily be upset by events.

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30. Again, the higher the level of taxation, the less likely it is that firms will consider it worthwhile to pass on higher direct taxation in the form of higher prices. A given increase in taxation will affect net profits far less when tax already takes over half of the gross profits (as at present) than when it takes a smaller proportion.

31. Now, for the same reasons, are reductions in taxation likely to result in lower prices.

32. As regards condition (b), it cannot be too readily assumed that even if firms can pass on taxes, consumers will be able to recoup themselves by increasing their incomes. In conditions of full employment, of course, the ability of wage and salary earners to secure increases will be improved, but there are limitations even in this connection, either imposed by circumstances or voluntarily accepted in the interests of maintaining full employment. Other sections of the community, particularly people on fixed incomes, State pensions and so on are subject to far stricter limitations.

33. For these reasons we do not consider that, as a general rule, direct taxes can be regarded as real or calculable costs, or that increases in taxation are likely to have substantial inflationary effects, so far as they affect prices, which will offset their deflationary effects as they affect incomes.

Taxation and incomes

34. Direct taxation, by decreasing or increasing spendable incomes will have directly deflationary or inflationary effects, particularly where the lower incomes are concerned. The first effect of taxing incomes is likely to be a reduction in savings: where this margin is small or non-existent then consumption must be reduced. It follows from what we have already said concerning the role of the Government in maintaining an adequate amount of saving and investment that it will probably be necessary to use direct taxation as a counter-inflationary weapon under conditions of full employment.

35. It is, however, essential that where short-term action is necessary to check inflation or deflation the method used should be speedy in its introduction and speedy in its operation. Changes in direct taxation do not satisfy these requirements: direct taxes on incomes and profits cannot be altered or come into effect quickly enough. It is a more efficient instrument than variation of the Bank Rate, but less efficient for the control of consumption than variations in indirect taxes and in social security contributions and benefits.

36. There is another factor to be taken into account—the need to avoid accentuating existing inflationary and deflationary tendencies. If this is to be avoided tax liabilities should be met as soon as possible after the income to which they relate has been earned. For this reason P.A.Y.E. is a far better anti-inflationary or anti-deflationary weapon than was the preceding system, under which taxpayers could find themselves faced with heavy tax-demands when their incomes were falling and with small liabilities at times when their incomes were rising. On this account also, therefore, we recommend that the system of pay-as-you-earn for wage and salary-earners should be maintained.

Conclusions as regards control of inflation

37. We consider that the importance of direct taxation as an instrument for controlling inflationary or deflationary effects lies in its effect on incomes rather than in its effect on prices. Direct taxation is not the most effective instrument for reversing short-term inflationary or deflationary trends, but it can and should be used for controlling longer-term tendencies towards inflation or deflation. It is, however, essential that as little time as possible should elapse between the moment when the income accrues and the moment when the tax is levied. On this account also, therefore, we recommend that P.A.Y.E. should continue.

DISTRIBUTION OF PERSONAL INCOMES

General

38. In this part of our evidence we propose to consider whether it is desirable to alter the existing system of taxation in order to secure a more even or less even distribution of net personal incomes for its own sake. We

are not here concerned with the further effects of redistribution on, e.g. incentives, savings, and the general level of economic activity, which are considered elsewhere in our evidence.

Purpose of redistribution

39. Where incomes are, before tax, seriously unequal we consider that redistribution by State action is justified in the interests of social justice. Direct taxation is, and must be, one of the main methods of securing a measure of redistribution, and progressive taxation, under which each additional slice of income bears a higher rate of tax, is the most effective and equitable means of direct taxation.

Direction and extent

40. Redistribution should be carried out in two directions, from rich to poor and from persons without dependents to those with dependents.

41. We do not agree with the suggestion sometimes made that the redistribution of incomes has gone too far and should be reversed. We do, however, recognise that on the whole redistribution through the taxation of current individual and corporate incomes has gone almost as far as is practicable and that there is little possibility of making much further progress along the lines followed up to now. Nevertheless there are within the present framework of taxation certain anomalies which should be removed.

42. Before we discuss these anomalies we would observe that the greatest cause of inequality of income derives from the inequality of capital possessions. Ways in which capital inequalities are or can be reduced—particularly the Death Duties and the Capital Levy—lie outside the terms of reference of the Commission. We have, however, noted the ruling given by the Chancellor of the Exchequer that the Commission's terms of reference enable them to consider the question of charging to tax profits ranking as capital profits under the existing law, and we shall, at a later stage, be submitting to the Commission our considered views on this matter in connection with 5 (b) of the particular matters listed under the Heads of Evidence.

Redistribution between income groups

43. It should be a principle of taxation that taxes are levied only on that part of the individual's income which is not necessary for maintaining, in conjunction with the social services, a reasonable minimum standard of life. This income will vary from one period to another with the current conception of a reasonable minimum standard. We consider that the present tax structure on the whole satisfies this principle, but we would urge the need for adjusting the basic allowances—particularly the exemption limit—fairly readily in response to changes in prices and in the National Income.

44. The present tax structure also goes some way towards satisfying the principle that unearned income should bear a heavier burden of taxation than earned income. There is, however, an anomaly which should be removed. At the present time no income earner benefits by more than about £190 per annum as compared with the person who receives the same gross income entirely from investments. The difference of £190 per annum first appears at the level of £2,000 per annum: up to that point the benefit is progressive. From that point—at which surtax begins—the progressive element disappears. We are therefore of the opinion that a progressive differential in favour of earned incomes should be incorporated in the surtax, by increasing the rate of surtax on unearned incomes. At present tax levels this would probably mean that the effective rate of surtax on unearned incomes exceeding £100,000 per annum would be at least 19% in the E. On excessively high incomes we consider that this, or an even higher rate, is not unreasonable.

Dependents

45. We hold that the tax system should discriminate in favour of persons with dependents. The present structure goes some way to achieve this, but is not in all respects satisfactory. We return to this point in the following Section (paragraphs 79 to 83).

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[Continued]

Conclusions as regards distribution of personal incomes

66. Whilst the process of income redistribution by direct taxation of incomes has been carried almost as far as is practicable, we consider that the rate of progression on the higher unearned incomes should be increased.

INCOME TAX AND SOCIAL SECURITY PAYMENTS AND CONTRIBUTIONS**General**

67. During the past few years several proposals have been put forward for amalgamating the income tax with the social security system. It is not our intention to consider and comment in detail on each of the various schemes, but to examine the general principles which they appear to have in common.

Objectives of the proposals

68. All the proposals aim at eliminating the duplication which results from providing assistance in respect of dependents partly in the form of income tax allowances and partly in the form of actual payments.

69. The proposals also have four subsidiary objectives. The first is to eliminate the disincentive caused by the divergence of average and marginal rates of taxation inherent in any system of taxation based on progression. The second is to alter the existing distribution of incomes, particularly in order to help people with dependents. The third is to increase the Government's ability to control cyclical fluctuations by means of social security payments. The fourth is to simplify the administration of the income tax and make it more intelligible. Not all of the proposals, of course, have all these subsidiary objects, and the emphasis which is laid on the importance of the objects varies.

Method

70. These objectives would be attained by three main methods. First, the existing income tax allowances (e.g., children's allowances, and married allowances) would be abolished, existing social security allowances expanded and new social security allowances introduced. Second, a flat rate tax would be imposed on all incomes up to a certain point. Third, one agency would be used for paying all the allowances, instead of some being paid by the Ministry of National Insurance and others being credited through the Inland Revenue's machinery.

Duplication

71. The primary objective of these proposals is to eliminate the duplication which arises from the fact that, quite apart from the benefits available under the social security schemes, there is embodied in the income tax structure a complex system of family allowances. It must be admitted that there are many illogicalities in the existing arrangements, particularly in so far as they embody allowances which vary with income and which are not enjoyed by people whose incomes fall below the taxable limit. To the extent that the proposed schemes would remove these illogicalities they would obviously be desirable.

72. Another advantage claimed for some of these proposals is that social insurance contributions could be abolished. These, it is urged, can be regarded as a flat rate tax on all employed persons, a form of employment tax which is not related to the individual's capacity to pay. We are not, however, satisfied that the abolition of these contributions would be desirable. Their elimination would mean a departure from the insurance principle, to which so much importance was attached by Lord Beveridge in his Report on Social Insurance and Allied Services. Even though the full cost of the social security provisions is not met out of contributions, we are of the opinion that, at least for the present, this principle should be maintained. On the one hand, people should be aware that there is some relation between what they pay and what they get; on the other, we consider that it is desirable that individuals should feel that they are entitled to State benefit because they have helped to pay for it directly, not feel that they are, in some way, in receipt of charity.

73. Our first conclusion, therefore, is that it would be, in principle, desirable to eliminate many of the existing income tax allowances, but that social insurance contributions should be maintained.

Elimination of disincentive

74. The second objective is to eliminate the disincentive caused by the divergence between marginal and average rates, which, as we pointed out in paragraph 15, can only be eliminated completely by levying a flat rate of tax on every pound of income. We would point out that the introduction of a flat rate is not contingent, as is sometimes implied, on the elimination of allowances; allowances could be left in and a flat rate charged thereafter. If, however, this course were followed, the advantages claimed for the proposals would be seriously reduced, as not only would the disincentive arising from a higher marginal rate of taxation partly remain, but the existence of allowances would necessitate calculations of tax liability similar to those now required.

75. All the proposals made recognise that an upper limit would have to be put on the operation of the flat rate: the figure usually suggested is £500 or £600 per annum, beyond which the rate (including surtax) would be progressive. This, of course, would mean that the disincentive of a high marginal rate of tax would not be removed for people earning about £10 or £12 a week: on the contrary the existence of this limit beyond which taxation increased sharply might dissuade workers from so increasing their earnings that they passed this point. This limit would certainly affect many people on piece-work and other payment by results schemes, and a special or "supplementary" tax might have a greater effect on them than does the present graduated system. Moreover, a worker whose earnings are approaching £10 or £12 a week is, generally speaking, not feeling the pinch of need—he will be more discouraged by a higher rate of tax than will a worker on £6 or £7 a week: if, however, the limit is reduced then the administrative difficulties are increased, whilst if the limit is put higher it raises the problems discussed in the next paragraph.

76. Fundamentally there is an even stronger objection, on the grounds of equity, to instituting a flat rate tax. If we assume that all allowances are abolished, then the flat rate must operate on every pound of income. If the tax is to yield any revenue at all it must mean that persons pay tax who were previously exempt—at the lowest levels they are therefore worse off, and the higher the flat rate (suggestions vary from 3s. 6d. by Mr. S. P. Chambers to 6s. 8d. by Lady Rhys-Williams) the worse off they are. This, it is argued, can be made up to them by a flat rate grant from the State, as, for example, on the lines advocated in the Liberal Party's proposals.* This, however, gives rise to one of two evils. If the State grant is at a low level, the people with the lowest incomes will still suffer: if it is at a high level to prevent them suffering then the individuals on the higher range of incomes benefit excessively.

77. Inequities are bound to arise in this sort of scheme. Where income tax is levied on individuals not previously liable to tax, they can only be protected by being given a cash allowance. The choice then lies between giving everyone the same allowance, in which case the better-off receive allowances which in any case they probably do not need, and giving varying allowances, which defeats the whole purpose of the change.

78. We do not therefore consider that the introduction of a flat rate of tax would in practice secure the increased incentive which is claimed; or that it could be operated in an equitable way without causing administrative difficulties of the kind it is meant to solve.

Redistribution

79. The third objective is to secure redistribution of incomes, particularly in favour of people with dependents, and it must be admitted that the present system of income tax is not wholly satisfactory in this respect. To take one example, we believe that it is a justifiable criticism of the existing system that married couples living on small incomes receive far less benefit from the children allowance than do those on higher incomes. The causes are that as income increases (up to a point) so the value of the allowance increases, so that the people who need the most help get the least; and that the extra money available for spending on each child diminishes as the families of people on lower incomes grow, but not if the parents of the children happen to be well off.

* "Reform of Income Tax and Social Security Payments," March, 1950.

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[Continued]

80. With this anomaly in mind we have given careful consideration to the possibility of eliminating some of the worst effects by abolishing the children allowance and, in its place, expanding the existing Family Allowance. This, however, would give rise to further anomalies. Perhaps the main consideration is that the Family Allowance would have to be set at a level high enough to ensure that no married couples with children were worse off than they are at present: otherwise they would, at each level of income, be worse off relatively to single people and married couples without children, whose tax liability would of course be unchanged. However, this means putting the Family Allowance at a very high level—probably not much less than fifteen shillings for each child free of tax. The alternative is to introduce a special tax on single people and childless married couples, which would defeat the object of simplification.

81. An alternative way of eliminating the anomaly described in paragraph 79 would be to vary the income tax allowance for children as between income groups. This, however, would be administratively cumbersome to operate and would still not help the children of low-paid workers who are not now liable to tax.

82. We must therefore admit that, although we sympathise with those who criticise this anomaly, we are unable to recommend any alternative method which would not in its turn create new anomalies or administrative difficulties. There may be a case for increasing Family Allowances, but we recognise that this lies outside the Royal Commission's terms of reference.

83. If there is no case for abolishing the children allowance and expanding Family Allowances, then the case against adopting similar methods of eliminating similar anomalies in the operation of other dependents' allowances is even stronger; the machinery for paying out Family Allowances already exists, but to pay other dependents' allowances by the same method would require new machinery.

84. As far as redistribution between rich and poor is concerned, the proposals made in these schemes do not provide the best or the only method. We have, indeed, already given an indication of the iniquitous way in which the proposals would work, and even if a scheme could be devised which would eliminate these inequities this in itself would not constitute sufficient reason for introducing it. The case for its introduction must rest on stronger grounds than this.

85. We are not of the opinion that the most desirable way of redistributing incomes is by providing large State cash grants at a flat rate to all citizens, irrespective of need. We are strongly in favour of the State provision of a fall-back income, paid as at present to people when they need it most—e.g. when they are unemployed, sick or aged. But we consider that if State subventions were to be extended indefinitely a point would be reached at which their economic disadvantages would outweigh their social advantages.

86. We therefore consider that there is no case for claiming that schemes of this sort are necessary for, or are the best way of, redistributing incomes in the direction we believe proper.

Control of cyclical fluctuations

87. The fourth objective is to increase the Government's power to control cyclical fluctuations by varying social security payments in order directly to stimulate or decrease consumer expenditure. The extent to which the Government's power is increased depends on the level at which social security payments are fixed: these proposed schemes, therefore, would only help towards the object to so far as they embodied higher levels of social security payments.

88. We consider that it is in principle desirable that the Government should have at their disposal an instrument of this sort for combating threatened unemployment. It does not necessarily follow from this that the proportion of the individual's income which comes in the form of a State cash payment should be indefinitely large, since this could bring disadvantages of its own. The main disadvantage is that State subventions, in spite of their obvious merits, tend to obscure the relation between earnings and effort and to reduce incentive. We do not

believe that at their present levels their effect in this direction is important: certainly at the moment their social advantages far outweigh whatever disincentive effect they have. If, however, these payments were to be increased substantially, and, above all, if they were to take the form of large weekly cash payments to everyone, whether employed or unemployed, sick or well, their effect would be much greater. Also to be considered is the way in which such regular weekly payments might reduce the real wage differentials between different classes of workers. Moreover, the importance of these factors varies with the level of income tax: the higher the weekly social security payment the higher must be the rate of tax, and thus there is a two-fold effect on incentive and on real differentials. Finally, there is the consideration that the higher the "standard" weekly State subvention, the more difficult it is to increase this if a recession should develop. In any case, we are of the opinion that this objective lays too much stress on the negative aspect of combating unemployment, rather than on the positive aspect of maintaining full employment.

89. We are not, of course, arguing here against the principle of State social security schemes, or against the existing level of contributions and benefits. Nor are we concerned with whether or not existing benefits, are, on other grounds, high enough. The question is whether the linking of social security payments and benefits to income tax would increase the Government's power to combat cyclical fluctuations without bringing greater disadvantages in its train. We are of the opinion that the disadvantages would in fact outweigh the benefits.

Simplification

90. The final objective of these schemes is to simplify the structure and administration of the income tax and make it more intelligible to the taxpayer. This, it is claimed, would result from the elimination of the coding which is necessitated by variations in allowances. This would make the tax more intelligible (particularly if progression was replaced by a flat rate) and would lift a heavy burden from the shoulders of employers, as well as making administration by the Inland Revenue simpler. This objective is obviously desirable, but we are not satisfied that the claims made in the proposals are not exaggerated.

91. In the first place, to abolish children's allowances and dependents' allowances would not eliminate all allowances—for example, tool and clothing allowances and relief on life insurance premiums would remain and could not satisfactorily be commuted into cash payments.

92. In the second place, the difficulties of paying out expanded social security benefits appear to have been under-estimated. The Income Tax Authorities would certainly be relieved of assessing the effect of, e.g., dependents' allowance, but another Department—presumably the Ministry of National Insurance—would become responsible and could not, as sometimes seems to be implied, absorb the additional work without considerable expansion. If the actual paying out was done by employers this might even increase the work of wages clerks, who, instead of calculating one stoppage (by tax-tables) would have to calculate a stoppage and also set off against it a payment to the employee.

93. In the third place, central assessment would not be abolished. If evasion was to be prevented it would be necessary for the Inland Revenue to maintain records of tax liabilities and payments. If, in addition to increasing social security benefits, they were paid weekly (as proposed by the Liberal Party) to or in respect of every individual, this would mean a considerable expansion of administrative facilities in order to carry out payments and prevent the payment of double allowances to persons having more than one income. It would also be necessary to maintain a constant check on all records instead of dealing only with that comparatively small section of the community which is receiving State Assistance in any particular week.

94. In the fourth place we have in this subsection deliberately left out of account those aspects of the proposed schemes which might help towards simplification but to which we object on other grounds—for example, the introduction of a flat rate and the abolition of the social insurance contribution.

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[Continued]

95. We are not, therefore, satisfied that the proposed schemes would in fact produce the simplification and greater ease of administration that it is theory claimed for them.

Conclusions as regards linking Income Tax with Social Security payments

96. On the whole, therefore, in our opinion a sufficiently strong case has not been made out for radically reforming the present system in order to amalgamate the income tax and the payment of social security contributions and benefits. We criticise these schemes not because they fall short of the ideal, but because they satisfy the aims of equity and simplicity no better than—and in some ways, not as well as—existing arrangements. Likewise we do not oppose these schemes on the grounds that their introduction presents considerable difficulties: nevertheless these difficulties are very real ones, and any proposal to alter the present arrangements must show beyond all reasonable doubt that the advantages of the new system would outweigh not only its disadvantages but also the administrative difficulties of its introduction.

GENERAL CONCLUSIONS

97. For convenience the conclusions reached in the preceding sections are brought together below:

(a) Incentives

We are of the opinion that the disincentive effects of P.A.Y.E. are not such as to justify the introduction of special rates of tax for income derived from overtime and extra effort. We consider that there is a case for a smoother graduation of taxation up to the point at which the standard rate applies, and that more should be done to let taxpayers know how P.A.Y.E. works and how it affects them.

(b) Risk-bearing

Other things being equal, a high and progressive rate of taxation will reduce the willingness and ability of individuals and corporations to invest at risk, but the use of the resulting revenue by the Government to promote full employment and the consequent reduction in the riskiness of investment generally must also be taken into account. The available evidence does not suggest that there has yet been a marked shortage of risk capital for enterprise. We consider, however, that the Government can and should undertake to provide risk capital where necessary.

(c) Savings

We are of the opinion that the present system of taxation reduces the willingness of individuals to

save although, on balance, it may increase the willingness of corporations to save. Again, however, the system of taxation cannot be considered in isolation from the objects of taxation and the use to which the revenue is put. If the object is to maintain full employment, and if the revenue is used to this end, the resulting high level of economic activity will mean that earnings are likely to be higher and capacity to save will be increased. From a national point of view, if in this situation the capacity to save is higher but the willingness of individuals and corporations to save is not strong enough, then the Government should increase its own saving and investment. In particular, the special taxation of profits is justified in the interests both of equity and of combating inflation under conditions of full employment.

(d) Control of inflation

We consider that the importance of direct taxation as an instrument for controlling inflationary or deflationary effects lies in its effect on incomes rather than in its effect on prices. Direct taxation is not the most effective instrument for reversing short-term inflationary or deflationary trends, but it can and should be used for controlling longer-term tendencies towards inflation or deflation. It is, however, essential that as little time as possible should elapse between the moment when the income accrues and the moment when the tax is levied. On this account also, therefore, we recommend that P.A.Y.E. should continue.

(e) Distribution of personal incomes

Whilst the process of income redistribution by direct taxation of incomes has been carried almost as far as is practicable, we consider that the rate of progression on higher unearned incomes should be increased.

(f) Income tax and social security schemes

In our opinion a sufficiently strong case has not been made out for radically reforming the present system in order to amalgamate the income tax and the payment of social security contributions and benefits. We criticise these schemes, not because they fall short of the ideal, but because they satisfy the aims of equity and simplicity no better than—and, in some ways, not as well as—existing arrangements. Likewise we do not oppose these schemes on the grounds that their introduction presents considerable difficulties: nevertheless these difficulties are very real ones, and any proposal to alter the present arrangements must show beyond all reasonable doubt that the advantages of the new system would outweigh not only its disadvantages but also the administrative difficulties of its introduction.

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EXAMINATION OF WITNESSES

2634. *Chairman:* We are very grateful to you, Mr. Geddes, and your colleagues for the papers you have sent which are very carefully argued and deal with your points very fully. All the Commission is thinking of doing to-day is clearing up any questions arising out of your documents on which we want to get our own minds clear. I wish you would tell me one thing, would you? You deal in paragraphs 12 to 14 of your first memorandum with the question of P.A.Y.E. as a discouragement to overtime and other forms of extra effort—Mr. Geddes: Yes, my Lord.

2635. From your experience how widely do people concerned know the details of the tax which is taken from their wage?—We think, my Lord, that the average person knows very little. He only knows the ultimate effect. Of course, in many cases he has a slip which tells him precisely the amount deducted and if income tax is the only deduction then he knows precisely how much has been deducted in that particular week. Where, however, there are a number of deductions which may vary we think probably by and large he is not sure, and certainly not quite sure, how it comes about.

2636. I was more concerned really with how it comes about, because no doubt there are fairly complicated factors which bear upon what the taxpayer is actually going to lose in any week. That would not be very widely known?—Very, very few of the ordinary workmen really know. They are told once a year in the newspapers of

the effect of the Budget on taxation, on income tax particularly. For that matter quite a lot of people outside what is known as the manual worker have a very hazy idea. I certainly have a very hazy idea myself.

2637. In your experience do they make some effort to find out how it works, or do they really take it on trust?—In the main it is rather too complicated, but I think to a very large extent it is because they do not try. They know it is going to happen anyway and accept the inevitable. That is our view.

2638. I only want your view from your experience. Are there occasional experts?—There are always those people who know more than the Inland Revenue Department themselves, whether they are effective in satisfying the individual I have some doubts.

2639. Before we go further, it is some time since you sent us in your document, is there anything else you would like to add to it by way of general supplement?—I do not think so. The documents now submitted generally cover the views we want to express.

2640. I see that in paragraph 15 you are dealing with the question of graduation. You do, I think, make as a proposal that there should be a greater number of steps before you reach the standard rate.—Yes.

2641. That, of course, has been met to some extent by the proposals in the present Budget?—That is so.

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[Continued]

2642. Indeed, there are I think the three steps which you mention here, 3s, 5s, 6d. and 7s. 6d.?—Yes, my Lord. I think it is the only thing Mr. Butler did that we asked him to do.

2643. Of course, he has done it on a wider basis. That having been done, do you still think it would be advantageous, if it was administratively reasonable, to have more steps still?—We say that, my Lord, and I think that is still our view. We say this should be the minimum. We hold that view because we feel the more gradual it is the less discontinue will be the effect on overtime and that sort of thing. It is the sudden change and rather big change that results in discontinuity.

2644. If the man is actually aware that the change is taking place?—Yes.

2645. Then you go on to deal with certain alternative schemes which you have had under your attention as possible variations of P.A.Y.E. You do not favour, if I follow your paragraph 16, any system which depends on making the rate of tax deduction dependent on the previous year's ascertained income and the current allowance?—No, we do not, because of the effect. It may be sound where the subsequent year's income is higher than the previous year, but it is very bad in our view when the subsequent year's income is smaller than the previous year. It can create quite a considerable hardship on the worker if he pays higher tax in a year when he is earning less income.

2646. The main ground of your objection is the effect of such a system on the man with a falling income, falling in the succeeding year at any rate?—Yes, my Lord.

2647. And then you go on in paragraph 18 to say that you have noticed the proposals for a weekly wages tax. That really means that the wage, whatever it may be in the week, stands by itself as the measure of liability, and you do not favour that proposal primarily because of its haphazard operation?—That, and one other factor which is that in a given year two people earning the same income may pay different taxation on that income.

2648. Yes?—Dependent upon whether they are earning a general average level throughout the year or whether they are earning very high sums in certain weeks and low sums in others.

2649. It would still be possible for them to think of themselves in terms of annual income and tax, and two people with the same annual income might have a different tax result?—Yes, my Lord.

2650. Yes. I wanted to ask you one question on your Table II in paragraph 26. Your theme there, I think, is stated at the beginning of the paragraph. "There has not been recently any indication of marked unwillingness on the part of private investors to provide capital for enterprises. Company issues have been buoyant." Those details that you give in Table II, I suppose, naturally, are taken from issues to the public which have been made largely through the machinery of the Stock Exchange or issuing houses?—May I ask one of my colleagues to answer that? Mr. Murray: If I may supplement that; those, as is indicated, are taken from figures issued by "The Economist" which include three categories of issues; first there are all issues offered direct to the public; second all issues based on statements for information only; third there are increases of capital by established companies who receive permission to deal on the Stock Exchange. Those are the three categories covered by "The Economist".

2651. The statements issued for information only would be issued with a view to dealing at some later date in the shares concerned?—That is our interpretation of it.

2652. I think so, yes. It is very illuminating when you are considering the provision of capital for new or unproved enterprises? They would not be the kind of thing which would be covered by issues to the public of this kind?—Yes, surely, under the first category, issues offered direct to the public would include the establishment of new companies for which capital was being raised for the first time. That is our impression. These figures are not completely first offers to the public but do include what may be a fairly substantial proportion of such offers.

2653. I follow that. What I had in mind was that I would not have thought this kind of machinery would have been used, the issue to the public in one form or another, to provide finance for the unproved business, the new venture.—Perhaps that is a matter of tactics on the

part of the people floating the company. In many cases they may raise it from private sources of which we would have no information.

2654. There would not be any figures available of the sums from private sources or private existing businesses?—We are not aware of any.

2655. Part of the criticism, of course, bears on the fact that the difficulty really exists in finding the kind of venture money which used to come, it is said, from the big private investor?—Yes.

2656. In paragraphs 40 to 44 you are dealing with the profits tax, and I think a good deal of representations that have come in to us have been rather hostile to that tax. If I gather rightly from paragraph 42, your main support of the profits tax is on the principle that you state there, that the community as a whole through the Government is entitled to share in the additional profits which accrue to companies in conditions of full employment. What struck me about that was, is profits tax, as it is constructed at the moment, really adapted to obtaining a share of the profits of those companies which are benefiting in this way? Does it not take it indiscriminately?—Mr. Geddes: Yes, Sir, I suppose so, but in times of full employment, which imply that there is a boom or part boom taking place, would not most companies be participating in that condition?

2657. I see your argument, but they must participate to very unequal degrees, must they not? Take a company deriving its income primarily from operations abroad; it does not primarily owe its profits to any activity of the community here, or only very indirectly.—It would be deriving those profits, would it not, from increased productivity on the part of the community if that were existing, even if it were exporting its profits abroad. If it is getting increased profits as a result of increased productivity we would submit that our contention here is a sound one.

2658. Yes, I was thinking more in the first place of the company which carried on operations abroad but controlled here.—I think that would be unanswerable.

2659. That is, if you like, the extreme case.—Yes, I agree. I think that clearly is so. It could not apply in those cases. Mr. Bowers: I think we are only making a broad point. There are many individual firms where that would not be the case. On the other hand it would be very difficult actually to find out just how far that was the case. Mr. Murray: Of course, the profits tax is in some senses a marginal tax. The main tax falling on companies is income tax, with which you can seek out and distinguish between firms of different levels of profitability. Thus the profits tax is now in some respects a rather clumsy and broad instrument and its importance is reduced. As I say in some cases it is a marginal tax.

2660. I should just like to know a little more about your proposal in paragraph 64. I think you are beginning with a proposal to carry the earned income relief which, at the moment, stops at what you get on £2,000 a year, up into the higher income level. And then, I think, you propose that that should be done, if I follow it, by a further charge on the unearned income on the higher level. That is the nature of the proposal, is it not?—Mr. Geddes: Yes, I think that is the nature of the proposal, my Lord. Mr. Murray: If I may add something, it does in fact amount to that. We do not propose that the present earned income relief as it stands now shall be carried straight through the structure of the tax. What we are suggesting is that over and above the present rate of taxation, which does not allow earned income relief upon certain incomes, this surcharge shall be on top of that, so that you will get the same result as if earned income relief had been carried through, but in fact do it in rather a different way. The surcharge will fall more heavily upon the higher unearned income and not make the man receiving the higher earned income better off than he is at the present time relative to the man paying income tax alone.

2661. I think I follow; I wanted to get it clear. I was not quite clear when I read it. The proposal is to make the higher unearned income worse off?—That is right.

2662. The worse off you make it, the better off is the man who gets his income from having earned it?—That is precisely the point we have in mind. We are concerned, I will not say to do justice, but a little more justice

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than of percent between the man who earns a very high income and the man who receives it from investments. We are not here concerned so much with the differentiation between the man with a very high income and the man with a comparatively small income.

2653. You do speak of a surtax rate of 19s. in the £ on the individuals who have unearned incomes of £100,000 a year.—As effective rate.

2654. I was not quite clear what you mean, the combined rate of income tax and surtax?—Yes.

2655. I see. Then I think from paragraph 57 to the end of the paper you go on to study the various proposals which we have heard a good deal about which would link the social security payments with the income tax system, either link it partly or in fact merge the two. In paragraph 72 you say, no doubt an important point, that you yourselves do not favour a proposal which would have the effect of abolishing contributions in respect of social security benefits.—Mr. Geddes: That is so.

2656. Chairman: Thank you. I think that has explained all the points I wanted to ask. In the end, for a number of reasons which you argue very carefully, you come down against these proposals for linking income tax and social security payments as not being an improvement on the P.A.Y.E. system, not being in itself an advantageous scheme?—Yes.

2657. Chairman: Now I will ask my colleagues to raise their questions.

2658. Sir Geoffrey Heyworth: On the question of simplification of the income tax system and the question of incentive; if we accept the view that no system based on the previous year or some previous period is feasible because of the amount of injustice to people with falling incomes, it does mean, I take it, that there is no other method whereby any wide field of simplification becomes possible? Is that right?—I do not know if we go as far as that. Our view is that the present system is certainly better than the alternative which you suggest. It might well have that effect.

2659. I do not suggest that conclusion is wrong at all, but it does seem to me to be important to see how big is the group of people that might be caused hardship. I take it nobody can answer that unless somebody will predict the future trend of wages. But over the experience of the last few years, would the number of people suffering hardship be at all great?—From the experience of the last few years I think the answer is no. On the experience pre-war I think the answer would be yes.

2660. Let us examine the period post-war for a minute. If you took the period from 1932 to 1938, would it have been large then?—Yes, because you have the factor of unemployment. A man might well have been unemployed for a period, and yet in the previous year he might have been in full employment and have earned a considerable income. Next year perhaps he would be unemployed for three months but he still has to pay tax on the previous year. You have the unemployment factor, surely that is a very important factor.

2671. Nobody has seen any method of speeding up the relief to those people?—It might be possible to devise one, Sir.

2672. The reason I am raising this point is that if we accept that view it does seem to me this question of simplification is more or less closed, that is all, and I take it you appreciate that point.—I think Mr. Murray, my Lord, would like to have a word on this. Mr. Murray: It is only a subsidiary comment. The fact would be (and I think very often this took place before the war) that when people were called upon to pay these sums of money in income tax they simply could not pay, and it would come down to a loss to the Inland Revenue and a consequent spread of the burden through the rest of the community. If this system were operating, for instance, in Lancashire today, although a comparatively small number of people, only a few hundred thousand, would be affected, nevertheless those few hundred thousand would be so a very ticklish position indeed; so that if there are only patches of unemployment nevertheless the size of the human problem concerned is quite large from our point of view, although they may only be a minority of taxpayers.

2673. Chairman: There is one thing I meant to ask you, I am sorry to start again. I think we did send you a short account of the American withholding system?—I daresay you knew it already. Did you have any opportunity of studying it?—Mr. Geddes: Yes, we have. We favour the system of P.A.Y.E. as against the American withholding system.

2674. You prefer our present system. You would agree it is a rather more complicated system?—We think it is better.

2675. What is your main reason for preferring our system?—Mr. Jones: First of all one of the considerations that occurred to us (although may I say this has not been before the General Council yet, we received the scheme so recently there has not been an opportunity to get an official view) the thing that struck us immediately was that the United States tax withholding system is on the non-cumulative basis although at the end of the year there is an adjustment to take account of income over the whole year. The point is that with the non-cumulative system you would not be able to take into account changes of earnings during the year for an individual employee. We feel that when you compare P.A.Y.E. with that system, P.A.Y.E. is a more convenient system to the wage-earner since it refunds tax at a time when his earnings fall or if he becomes unemployed, that is at a time when he really needs the refund of tax that is due to him. Then there is another point which struck us very forcibly and that is that with the United States system, I think it is stated in the paper which you sent us, it is only a matter of chance if the wage-earners pay by the end of the year just as much tax as is due on the total earnings for that year. Now suppose that occurred when that system were applied in this country. By the end of the year there may be quite a number of wage-earners who owe tax to the Inland Revenue, and the fact that they have to pay it in a lump sum we feel may cause hardship. I think we have pointed out in one of our memoranda that the worker tends to live on a week to week basis and he simply does not put aside tax reserves. That was another thing which immediately struck us why the P.A.Y.E. system was preferable. A third thing which struck us as being really important was that the United States tax withholding system involves a deduction at the lower rate of tax, the figure given for 1950 was 20 per cent. of income, and it means that over the large range of wage-earners' income there is in fact a proportional tax. It would not necessarily follow if a similar system were applied in this country that we would have to adopt a proportional tax; but it did strike us very forcibly that the United States system is a less progressive system than the income tax system in this country. Perhaps the last point of note is that the personal allowances system which the United States Revenue authorities have set up is a much more rough and ready system than ours and we quite agree does lead to a simplification in the number of codings used, 10 compared with 170 for P.A.Y.E., nevertheless we want to be quite clear how wage-earners would be affected if there were any attempt to apply the personal allowances on the lines of the United States system.

2676. You would say the P.A.Y.E. system as you know it is better adjusted to do justice to the individual?—That is our view. Mr. Bowers: That may be necessary with the level of taxation in this country. In America with a lower level of taxation it may be easier to put up with rougher justice.

2677. Have you had contacts with the American unions concerned with looking after the American system in seeing how it works?—Not directly, Mr. Chairman. We have sought information on certain aspects of the tax system but not on the unions' particular experience with it.

2678. What I meant was, one can see it can create individual hardships because it is a rougher system and Mr. Jones has been pointing out where it can pinch. You do not know from your own experience whether it does create trouble in that way?—No, Sir.

2679. Mr. Millard Tucker: Can I ask you to go back to paragraph 8 of your memorandum. You set out the three reasons or the three ways in which it is alleged that P.A.Y.E. is a distinct disadvantage, one being because it discourages overtime and another because it may contribute towards absenteeism or unofficial strikes. There is one point upon which, speaking for myself, I am very

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anxious to be quite assured one way or the other. We hear from some people that P.A.Y.E. does have this effect; from others that it might have this effect and from you there is a statement that there is no doubt there is some truth in the allegations. Would it be right to say that at the very beginning of P.A.Y.E. these things may have been talked about a great deal more than they are now among the work people?—*Mr. Geddes*: I think that is probably true.

2680. Would it also be true to say that we are likely only to hear of the vociferous minority on this point?—I am not quite sure about that, Sir. It is always a minority because it is the odd one or two who are vocal. I think if you took the consensus of opinion of workers today they would probably hold this general view, or some of them, particularly on overtime payments.

2681. They would?—I think so. If you could get to the individual and ask him. I do not say that it has been taken in that way, that is my own personal view.

2682. I was going to ask you if you would be good enough to tell us one thing. We would probably look to your body as being one which is more closely in touch with the actual work people perhaps than any other representative body who has given evidence so far. Are these views ones you have collected by a general enquiry among the average workers or the shop stewards of various places?—I do not want to over-emphasise what I have just said from the point of view of the evidence. I said it was my personal view; it is. What is true is that we have had a number of resolutions on the T.U.C. agenda demanding that overtime shall be tax free, which is indicative of the attitude of mind certainly of the people who have put the resolution down. I am not sure whether that resolution has been discussed and defeated in Congress; certainly it has been tabled in an attempt to get Congress to approve of it and to make representations on those lines. My own personal view is that if you took the average man on overtime earnings he would probably hold the view that P.A.Y.E. was a disincentive to overtime because he does not understand the operation of the system. There is one point on this: I would like to remove what may be an ambiguity at the end of the second sentence in this paragraph where we say "In some cases workers may receive not less than their plain time rate when they work overtime for which plus rates are commonly paid". We are, of course, referring there to the hourly rate and not the net weekly earnings. We mean in a given hour his actual net pay may be less than the plain time rate for a week's work.

2683. I think we had all read that in that way. You see, at some stage or another, we have got to reach a conclusion about this. It may be that it is right to say that some men think this is so, but is there any real evidence anywhere that people have definitely refused to work overtime because of the effect of the tax that they will have to pay?—I think it would be fairer or truer to say this; that, whilst the effect of P.A.Y.E., and particularly the graduated rate of income tax and the fact that he pays a higher rate of tax when earning more, causes a man to wonder whether overtime is worth while, in the long run, despite these disadvantages, he probably performs it. In the long run it probably is not a disincentive; in fact it is only a mental disincentive.

2684. So far I do not think we have had any written evidence from, say, any owner or controller of a big business involving a lot of work people who have come to say "I cannot get my men to work overtime." I do not think we have evidence of anything so definite as that, but would you mind telling us what happens, as far as you know, in these big works? Somebody decides there has got to be overtime worked and worked, say, for a fortnight or so. How is that communicated to the men, and how could some say "Yes, we will" and some say "No, we will not." Tell us, if you can, how it works in practice. Perhaps you cannot, I do not know whether you can answer that—I am going to ask one of my colleagues to answer, if they can. *Mr. Murray*: As to how the information is communicated my impression is there are two ways; either the shop stewards are called together or, alternatively, the works council, and asked to tell the people on the shop floor that there is a job of overtime for the next fortnight; or, alternatively, a notice goes upon the notice board—"You will work

overtime for the next fortnight," which may or may not produce some reaction. Of course there are probably other methods, but I think broadly that is what happens. It is a rather more authoritarian approach than an appeal "Will you work overtime?" In engineering, for example, which is perhaps most liable to overtime work particularly at the present time, as you know they have a procedure agreement by which the management are entitled to ask the workers to work so much overtime within a period of four weeks, so that as far as the individual's reaction are concerned when he gets that appeal, my impression is that on some occasions the worker may tend to make a stalling horse of P.A.Y.E. He may have a good many reasons for not wanting to work overtime, he may want to go to the pictures, take his wife out, and sometimes he tends to say "Oh, P.A.Y.E.—it is not really worth working overtime," whereas really if you can get underneath it is some other reason, and P.A.Y.E. is used as an excuse where in fact there is some other more cogent reason. That is not, of course, always true. We find it extraordinarily difficult to make generalisations about this, that is why we have put in this rather qualified statement here. By and large, P.A.Y.E. is a useful excuse, a convenient objection; nobody likes paying tax. Every body is perfectly prepared to agree with everyone else pointing out that a bad thing it is, but it may in fact partly be camouflage. *Mr. Bowers*: Quite definitely we have no positive evidence that P.A.Y.E. is a reason for not working overtime. It is true, as Mr. Geddes said, that there have been resolutions to that effect at Congress from time to time, but of course we have resolutions on a great many subjects and these did not receive any great volume of support. This memorandum was put to the Congress last year and was accepted. As far as I remember there was only one opposing individual delegate who immediately made it clear from his speech that he was thinking not so much of the system of P.A.Y.E. as of the general level of taxation. We think there is often a confusion of mind between those two points.

2685. Yes. Can I sum it up like this? As you say, you have no definite or concrete evidence that this system operates against overtime, but if it really did to any great extent, if it did extensively, you would have expected to have communications, I suppose, from some of your constituent unions long before now to tell you to put this point forward?—*Mr. Murray*: I think the answer would be we would have had more.

2686. We have talked about overtime. Would you tell us your view about the encouragement of absenteeism on the ground that the man only has to go absent to get some repayment without working for it?—*Mr. Geddes*: I think our answer to that is we do not accept it. We are dealing with what is alleged to happen. Generally speaking we do not believe that is true.

2687. It might be true in a few isolated cases?—Certainly it might be true.

2688. One swallow does not make a summer? That is your view, that it has been exaggerated, is it?—*Yes, Sir*.

2689. I have only one other question, which relates to a matter upon which the Chairman, I think, questioned you on paragraph 64, in which you suggest that there should be some differentiation in favour of earned income both for income tax and surtax purposes: do you think it is a good thing to send the rate up on earned income until it reaches, no matter what the income is, say, 19s. or as now 19s. 6d. in the pound? Do you think that is good?—It depends upon the circumstances that exist. We think it is good in present circumstances.

2690. But you see after £15,000 a year now the total rate goes to 19s. 6d. in the pound. £15,000 a year sounds quite a satisfactory salary for anybody to get, but taking the man, if there are any left now, who is running a business in which he has got to make substantial profits merely for the purpose of ploughing them back again, what do you say about his position with 19s. 6d. in the pound to come off the profits after £15,000?—I think we are dealing in the main here with individual incomes. If we take the case of the man with £100,000 a year after deduction he is left with £5,000 net. In present circumstances with the present demands being made upon the community for the need for taxation for community

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purpose, we would have thought that anyone with £5,000 net income was not badly off in relation to anybody else, and that he was not being called upon to make an unbearable sacrifice, even if he was called upon to make some sacrifice. For example a man in a very much lower income group after paying tax is probably left with say £300 or £400 a year against the other man's £5,000 a year. It is a question of relative sacrifice. If he is left with £5,000, is there a sacrifice?

2691. With all respect you are not really answering the question I put. I had left the man with the salary and assumed that £5,000 was enough for any man no matter what his responsibilities are, or what he has got to spend in any event because he holds that position. But I am coming to the business man, the man who owns a business, a small manufacturing business who makes a net perhaps extravagant profit of £30,000 a year. Now he wants a lot of that profit for the purpose of keeping it in his business as he could do if he had incorporated a company instead to carry on the business. What do you say to that sort of position of the individual who wishes to remain the owner of his business and not to have the trouble of a company?—I might perhaps ask somebody more expert to answer.

2692. I am addressing my questions to any of you.—Mr. Murray: I think your comment on that would be that it would be very difficult to accord specially favourable treatment to a man because he happened to be running a business. This would discriminate against the lawyer, doctor or accountant who may be getting as much but who cannot say, "I have a business in which I have to replace machinery, equipment, etc." I think our answer would be if the man cannot possibly keep his business in running order he should float it off as a public company. We would say the trend is in that direction. Many others have had to do it and we have no particular objection to seeing the number of public companies increasing and the number of private companies decreasing. I think we would rest our main point of objection on the undesirability of discriminating between individuals in comparable positions with the same gross income. We hold no particular brief for the small privately owned manufacturing company. We recognise in many ways it has contributed in the past to the well-being and the development of industry in this country. If equity on the other hand clashes with the expediency of keeping such a company in existence, we say the expediency must give way.

2693. You have no thought for the possibility of the destruction of enterprise and initiative and so on?—Not destruction of enterprise and initiative, I do not think we could accept that. In fact in many ways I am quite sure that public companies are just as enterprising and the managers of those companies show as much initiative as many private and perhaps backward companies. I do not think we could distinguish so sharply between the kinds of industrial environment which promote enterprise.

2694. Mr. Kaldor: I think one point ought to be cleared up which I am sure Mr. Tucker did not intend. A man who owns a private company is entitled to the same tax treatment as would be the case in the public company?

2695. Mr. Millard Tucker: Yes.

2696. Chairman: I think Mr. Tucker was really speaking of a business not incorporated at all.

2697. Mr. Kaldor: The question really was whether it should be incorporated or not.

2698. Mr. Millard Tucker: I was putting the case of the individual who carries on a business in his own name without having the benefit of incorporation at all. That is what I was dealing with; however you have answered that.—Mr. Jones: There was a further point I think, if it could be shown that the one man business had good reasons in its favour, if it could be shown that that was so and we were asked, "What is the best way of relieving the one man business of taxation?" I do not think we would agree that the best way was to have a general remission of taxation on unearned income. There might be a more specific way. There might be a way of giving him a specific tax free allowance, an initial allowance to expend so much, and that would be a more selective and discriminating method than a general

remission on unearned income. But our general attitude to unearned income would be that it should be taxed at a heavier rate than earned income. The question as to the actual rate, the amount in the pound which is taken in tax depends on so many other things, the amount of revenue to be raised, the purposes for which taxation is to be used and so on and so forth.

2699. I was really leading up also to the question whether you disapprove of such a high total rate as 19s. 6d. in the pound—I do not think we do. When you take into account the very heavy taxation there is, we feel in the interests of social justice it is not unfair that people should be called upon to pay the very high marginal rate of tax on such a large income.

2700. 19s. 6d. in the pound is a little more than taxation, it is practically confiscation, is it not?—That is one way of putting it.

2701. For all practical purposes it is confiscation.—Mr. Murray: Surely no more confiscation than any form of tax is confiscation? I do not think we could accept that view. We would agree that the burden was a very heavy one. But surely it is not a question of its being good or a question of our approving it? We have to take account of the whole nexus of taxes and say "is this way of raising tax better than that way?" "Is this more just than that," and so on and only on those grounds.

2702. I thought your colleague was justifying it on the footing of social justice.—Mr. Geddes: Social justice in present circumstances, yes, in the light of the need for the present high level of taxation and the purposes to which the revenue is put. We would say when a man gets an income which justifies a rate of 19s. 6d. he is not making undue sacrifice compared with other members of the community, because his rate of tax is related to his income and ultimately he is left in the main very much better off than the vast majority of the community even after he has paid or has had 19s. 6d. in the pound confiscated. He is still better off than the vast majority and his actual sacrifice is infinitely less.

2703. You are speaking, of course, of the salaried man, a man who gets a salary for the job, say £30,000 a year.—I am talking of anyone with an income which justifies 19s. 6d. in the pound.

2704. I was asking questions about the man who owns his business and supports a considerable number of work people.—I was not speaking of him.

2705. And could extend, if he could keep his profit and put it back into the business. You do not differentiate in any way in that respect?—Mr. Bowers: Mr. Jones has indicated if it can be shown that people with private businesses are in sufficiently difficult circumstances there might be special treatment for them, but we do not think that is sufficient reason for giving everybody a remission of taxation.

2706. Mr. Millard Tucker: That deals with the only two points I really wanted to be satisfied about.

2707. Mr. Carrington: Following your last answer what would your view be on this proposition: that partnership firms should be charged to income tax as at present and that the partners should be charged to surtax only on the sums withdrawn by them from the partnership assets?—We have to say, my Lord Chairman, that that is not a proposal to which we have given consideration but we are prepared to do so if the Commission wish.

2708. In regard to a question put to you by the Chairman you suggested that the overall rate of tax on incomes of £100,000 should be increased to 19s. in the pound. Do you realise that at the present time in the case of a married couple without children with an investment income of £100,000 the present effective rate is 18s. 10½d.—Mr. Murray: Yes, Sir, we do appreciate that, and indeed it was 18s. 10½d. last year when we in fact drew up this memorandum. But there are two points. First, we did say "would be at least 19s. in the pound". We have no particular objection to going a little over if it would be administratively difficult to take that figure. We are of course talking about effective rates. The second point is that a comparatively small change, cumulative change, up through the surtax structure might well carry the rate a little above that. This might well raise a considerable amount of revenue not only from these people paying

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14d, more in the rate but also from those further down paying 4d. A little more on the effective rate after the point (I think it is £20,000), at which the top rate of surtax begins to operate, a very small margin there would not worry us unduly.

2709. You suggest it would raise a considerable amount of additional revenue. Do you recollect what the present yield of surtax is? Is it not about £120 millions or something of that order?—I only have the 1949-50 figures before me for tax on incomes over £20,000. It is only a matter of £59½ millions, it was only a matter of that then; it may be something like £65 or £66 millions now, I do not know, but this proposal is not meant primarily as a revenue raising tax but mainly to recognise that the earned income earner in the surtax ranges ought to be given some incentive and ought to see that he is not in fact as badly off as his cousin or brother who has the same income but does not earn it in the full sense.

2710. You do not think the better form of incentive would be to give the earned income recipient some earned income relief in so far as his surtax is concerned? Give him a real encouragement instead of merely the sadistic satisfaction, shall I put it, of seeing someone else earn a little harder?—We should hardly get any sadistic satisfaction out of this because we are not concerned.

2711. No, you have mislaid my point. The only encouragement you are going to give to the income earner who is in the surtax range is to enable him to look at his neighbour in receipt of unearned income and say, "Ah, he is worse off than I am?"—That may be a form of satisfaction. Presumably that is incorporated in the present income tax structure by virtue of the earned income relief. I would once again stress we are not concerned here with differentiating between or comparing people on a very high income and people on low incomes. We are only concerned with people on very high incomes who either earn or do nothing to earn those incomes.

2712. My question is concerned with incentive to the surtax payer. Do I gather that the only form of incentive you have to offer to a surtax payer is to tax someone else a little higher?—Mr. Geddes: He gets a certain amount of virtue out of the fact that he gets more because he earns it, the other gets less because he does not earn it. That is a virtue, not a sadistic idea.

2713. I am afraid in this very materialistic world it is not a very great incentive to see someone else taxed a bit higher.—It is to know that you are taxed less.

2714. I think that is a matter of opinion which we will leave at that point. I now come to another point arising on previous questions. You agree that the profits tax is a somewhat clumsy instrument. In that connection a point was put concerning profits earned abroad by companies controlled in this country. We have been asked by other witnesses to consider some scheme whereby such profits should not be assessed to United Kingdom tax unless and until they are remitted to this country. What is the view of the T.U.C. on that?—Mr. Bowers: My Lord Chairman, we have no considered view. We excluded this point from our field in considering what we should say to the Commission.

2715. We will leave that one there then. Have you considered another point that has been represented to us and that is that the scheme of company taxation should be changed so that it should be merely a single tax on company profits and then, if those profits are distributed by way of dividends, that they should be subject to income tax in the hands of the recipient as is the case in Australia, for example, and the United States and Canada? Have you considered that at all?—Mr. Jones: No, Sir, we have not considered that specific point. Mr. Murray: I make one point, Sir, there is a general principle, that is that, of course, the General Council would be glad to give consideration to such a scheme if it led to a simplification of administration. We have stressed in this evidence that if you can get the same results in a simpler way then of course there is everything to be said for adopting the simpler way. We have not considered the alternative suggested, but if it had the effect of maintaining the present overall picture then of course there is everything in its favour and we would not deny that.

2716. In your consideration of profits tax have you considered this much debated point as to whether preference dividends should be allowed as a charge in computing

profits tax liability?—Mr. Jones: There again the General Council have not formally considered that problem. We did look at it, some of us, and we certainly do not see why the preference share dividend should not be charged to tax in so far that it is a distribution of profits and hence is quite clearly distinct from the debenture interest. There is a second point that, if you do not tax the preference share dividend, then there may be quite possibly cases of evasion in so far that there may be a tendency for preference shares to be issued rather than ordinary shares.

2717. Mr. Clegg: The matters I would like to raise spring from the very interesting formulation of the objectives of fiscal policy set out in paragraph 5. First, full employment at rising standards of living, and then there are listed a number of subsidiary or contributory objectives. I was surprised to find that one object which I should have expected to find there was not stated, and I wondered whether the omission was deliberate. Would you agree that one object of fiscal policy should be to contribute towards stabilising the purchasing power of the currency?—Mr. Murray: Yes, I think we would concur with that in general, Sir. This I should stress is not meant to be an exhaustive list of objectives of fiscal policy. There are others no doubt which you would include in an endeavour to catalogue them, but these were what seemed most likely to help to maintain full employment. We approach this subject with this concept of full employment very strongly in mind, and it was that aspect which we were particularly looking at. As far as stabilisation of currency is concerned if it is possible to achieve that by your fiscal policy then of course that is obviously a desirable objective. Mr. Bowers: In a way it is implicit, because I do not think we would have full employment at rising standards if you had wide fluctuations in the purchasing power of the currency.

2718. I gathered from something in paragraph 7 that you were not altogether of one mind on the question whether the two objectives of full employment and stabilising the purchasing power of the currency are reconcilable. There was a phrase there which indicated there was some doubt in your minds.—Mr. Murray: It is an open question, even the economists, I understand, are not agreed whether you can have full employment without constant pressure towards inflation. We do not pretend to know, and that is why we left the question open there. We are not at all sure that they are irreconcilable objectives, but as I say, it is an open question as far as we are concerned.

2719. You go on in paragraph 7 to suggest that because the rise in prices over the past ten years has been largely due to international factors there should on that account be no fundamental changes made in the tax system. What fundamental changes had you in mind? What sort of things should not be done for that particular reason?—Mr. Bowers: I think what we had in mind, my Lord Chairman, was that there has, of course, been a very powerful body of opinion which has put forward the view which has just been suggested, that perhaps full employment is impossible without a considerable degree of inflation and that therefore it is in the long run impracticable, or at any rate impracticable to the extent to which it has been attempted in the last few years. All we were wanting to do in that sentence was to point out that there have been some extraneous factors which should be separated when considering the problem.

2720. But what sort of changes in the tax system does that consideration rule out in your mind? You make the point that it would therefore be unrealistic to make fundamental changes merely to meet what may prove to have been abnormal conditions.—I think it would be with the people who wanted to change the system to suggest in what way they wanted to change it. We merely say because there have been certain difficulties, certain pressures on the economy from outside, they should not be made the reason for doing something on the basis that they have arisen from internal causes, if I make myself clear. I do not think that we had in mind any particular changes in the tax system, but we were rather taking a defensive attitude that it would be for whoever wanted to change it to justify the need for that change.

2721. You would not regard as a fundamental change the proposal you put forward in paragraph 63 that basic allowances should be adjusted fairly readily in response

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[Continued]

to changes in prices?—*Mr. Murray*: I do not think we would regard that as a fundamental change. It has been the practice in the past, with a time lag I agree, to adjust these basic allowances and, of course, the Chancellor of the Exchequer has seen fit to do so in his recent Budget. We would regard that as being an alteration in practice occasioned by the rather quicker tempo of prices during the past years, but not a fundamental change.

2722. Your plea there would be for a prompter and more elastic procedure of adjusting these allowances to changes of price level than we have practised in the past?—*Rather prompter*. We recognise that it should not be automatic, but it should be brought into operation rather more promptly.

2723. But not automatic?—Not automatic in the sense that in framing the Budget you would measure your change in prices by some sort of index and automatically adjust them immediately.

2724. You would apply this to the exemption limit?—Yes.

2725. And to the wife and child allowances, I take it, and to the earned income relief; is that right?—To all basic allowances, yes.

2726. If you did that pretty promptly and readily in a time of rising prices, you would, of course, have to adjust the burden at some other point in the tax system, because you must maintain your disinflationary Budget, must you not?—*May I interrupt you, Sir?* That is assuming you are, in fact, in an inflationary situation. You may have rises in prices and the national income without being in an inflationary situation.

2727. Let us presume an inflationary situation?—Yes.

2728. You would have to counter-balance those seriousness by heavier taxation at some other point?—Yes.

2729. And the adjustments would be fairly heavy in some of amount, would they not?—They would be, yes.

2730. And where would you hope to find the compensatory revenue; in what direction? I mean direct or indirect taxes, or where?—*Indirect taxes*, of course, are outside our province here, but I think that is rather too hypothetical to be dealt with by a generalised answer. Obviously if we were in an inflationary situation, the fact that prices and the national income were rising might not in itself be held by the Chancellor of the Exchequer of the time to justify an increase in the basic allowances immediately, and he may well be justified; so that, as I say, this is not, and should not be considered as a hard and fast ruling or as some sort of automatic adjustment, but as a proposal which has obviously got to be considered in relation to the general economic position.—*Mr. Jones*: Just one point. Our general view, I think, is quite clear on this. We say:—

"It should be a principle of taxation that taxes are levied only on that part of the individual's income which is not necessary for maintaining, in conjunction with the social services, a reasonable minimum standard of life."

We should have thought that was a general principle which would be accepted. We quite agree when prices are rising the issue may come up that a number of people at present being taxed are not able to enjoy what is considered to be the conventional minimum reasonable standard of living. We think that that is important and should be taken into consideration, but as to whether that would occur, whilst at the same time it would be undesirable for a Chancellor to ensure a reasonable minimum standard of living for people because of the fear of inflation, our view is that we do not think that that would be bound to occur. We could not really say what would be the most desirable thing to do unless the concrete circumstances were in front of us.

2731. You would have the basic allowances adjusted not only in relation to changes in the price level, but also in relation to changes in the national income, and since that is mentioned as well as changes in prices I take it that means real national income and not national income in terms of money.—*Mr. Murray*: Yes, that is really a shortcoming on our part, and we should have said real national income.

2732. What is new to me there is the idea that the benefits from an increasing national income, real national income, should be disseminated by way of tax allowances, because I had always thought it to be the broad principle that the fruits of increasing productivity would be disseminated through wage levels; but is there any case for distributing them through the agency of the tax allowances? It seems to be rather a back-door way of doing it.—*Mr. Bowers*: I do not think we want to take the principle too far. All we were saying was, and we deal with this matter in rather more detail in Part B of our evidence,* that in adjusting these allowances there should be some regard to the growth in national wealth just because the growth in national wealth is intimately connected with the conventional standard of living and the idea of what a minimum subsistence is. That is the only reason we wanted that.

2733. There is no doubt in your mind then from all that has happened in the last ten or fifteen years that the practice of using the tax system as one instrument of economic policy as distinct from social policy is a very desirable move. Would that be a true statement of your views?—Yes.

2734. And you concede that point in terms of general overall policy and in terms of direct manipulation of the tax system to achieve certain specific economic objectives?—*Mr. Murray*: Yes.

2735. Do you regard the field as being wide open for any great improvements in that direction?—Do you mean further advances?

2736. Yes.—We do not know. We say that we start from the position that it is desirable to look at the system of taxation and see if taxation can be used to help secure particular objectives, but, as we pointed out in paragraph 6, the more the Government intervene in the economic and industrial life of the nation the greater is the need for flexibility but the greater is the danger of rigidity. Once again I am sorry that we cannot give a precise answer to your question, but it is a question of balance. We have to look at the thing point by point and ask the question whether an extension of the use of the tax system in this instance would be desirable. In general it is a development that we have watched with, I will not say pleasure, but with some satisfaction, and we are sure that it has been a desirable objective from the point of view of the community as a whole, and from the point of view of those wage earners whom we represent.

2737. You do, of course, recognise difficulties in your paper. You recognise the difficulty on the direct tax side of achieving sufficiently prompt action. Have you any suggestions as to how that difficulty might be overcome?—I have not myself. *Mr. Jones*: One of the points that is put forward in that connection is that taxation should generally be levied on current income, and, of course, current year's profits and so on. We realise there are very great administrative difficulties in bringing about such a system, and I think all we really do in the paper is to record the difficulties without being able to put forward any specific answer to them. It is one of the problems the Commission will face.

2738. Have you any views on the harmful effect of uncertainty as to the rates of taxation in forthcoming periods?—*Mr. Murray*: I do not think we have Sir, no.

2739. Do you see any advantage in the differential rates of profits tax, having in mind particularly the ends of economic policy?—Yes, indeed; that is a point we have dealt with in our paper. We think that the existence of a differential, and it can only be an opinion, has encouraged firms to plough back profits into their businesses with a consequent increase in efficiency and the level of production and productivity, so the existence of a differential there, we are satisfied, is a desirable thing.

2740. Then you would not be altogether in favour of the suggestion which Mr. Carrington put before you of a simple or single tax on profits which would replace the present income tax on profits plus profits tax plus excess profits levy; in other words a single scale of tax on company profits?—*That, Sir, would depend upon what form of allowances was being embodied within the structure in the form of industrial allowances, initial allowances, and so on, and we think there should be some*

* Not reproduced in these Minutes of Evidence.

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[Continued]

encouragement to firms to plough back their profits, but as far as Mr. Carrington's question is concerned we have not really studied that.

2741. Do you think you may be able to achieve that end by some means other than the differential rates of profits tax?—It is quite possible through the medium of allowances.

2742. There was just one point in your remarks about profits tax which I found difficult to understand, and that was the argument, if I have got it right, that profits tax is to be justified by the contribution which the State makes as representing the community towards the maintenance of full employment. That is a correct interpretation of your view, I think. What puzzled me was this: what happens if the State fails to maintain full employment? Would you suggest that would be a good reason for removing profits tax?—In these circumstances (I must admit we have a prejudice in favour of full employment, we have written this paper from that point of view) if a depression were to occur, obviously we would have to look at the whole tax structure, and ask at which point is it most desirable to adjust the structure, is it profits tax, income tax, or, possibly indirect taxes in order to combat this recession. At that stage alteration of profits tax would obviously come up for review, but whether that would be a beneficial action I would not like to say.

2743. *Miss Sutherland*: We have had some representations, particularly from the professional women's organisations, about this question of taxation of married women's incomes with those of their husbands. Have you given any consideration to the matter at all from the point of view of the women members of your Union?—*Mr. Jones*: No, we have not given consideration to that, neither have we had any representations.

2744. The other thing I wanted to ask was about these proposals for amalgamating income tax with the social security system. In paragraph 71 you say:—

"It must be admitted that there are many illogicalities in the existing arrangements, particularly in so far as they embody allowances which vary with income and which are not enjoyed by people whose incomes fall below the taxable limit."

Then in paragraph 73 you say:—

"Our first conclusion, therefore, is that it would be in principle desirable to eliminate many of the existing income tax allowances, but that social insurance contributions should be maintained."

Would you suggest that, without going to the length of this austere scheme which you disapprove of, you would shift some of these allowances on to the insurance field, for instance the first child allowance, and things of that kind? I wondered what you might be thinking of from that point of view.—*Mr. Bowers*: I think really we thought this was to a considerable extent outside the terms of reference, and therefore while we recognised there were arguments in favour of that we did not follow them right through.

2745. *Mr. Woodcock*: There is only one point I think, Mr. Geddes. The view of the General Council of the T.U.C. on Pay As You Earn is, I imagine, set out in paragraphs 9, 10 and 11, in 9 and 10 particularly?—*Mr. Geddes*: Yes.

2746. And this has been operating now for quite a number of years; since when, about 1943?—*Mr. Murray*: 1944.

2747. That is quite a long time for a scheme to operate?—*Mr. Geddes*: Yes.

2748. In that time you have had one or two resolutions of Congress, but there has not been much in the way of criticism from the Unions, that is direct letters?—I would agree that if you took the full consensus of opinion as it is expressed through these channels there would be very little criticism, but the question that was put to me, or so it seemed, was the attitude of the individual worker. I am not sure that the attitude of the individual worker as an individual, that is distinct from a member of an organisation which is not quite the same in this particular case, is the same as the view expressed through the normal channels. From the point of view of the individual I would have thought that there were, due to misconception I agree, certain views with regard to the disincentive effect of P.A.Y.E. on overtime earnings, but I would entirely

agree if I were asked to express the view of organised workers through their organisations that criticism would probably not be found.

2749. And, of course, there was a vast amount of criticism of the arrangements operating immediately before P.A.Y.E. was introduced?—Undoubtedly.

2750. And that was a system not unlike some of those which have been suggested to us.—Yes, I would accept that.

2751. And that was in the middle of the war when wages generally were rising pretty well all the time.—Yes.

2752. And yet the difficulty would obviously be greater if they are paying out of reduced income a higher tax.—I think that is a fact.

2753. Would it not be the view of the General Council if you had not had P.A.Y.E., and I mean exactly P.A.Y.E. with the cumulative tables, repayment and so on, it would be quite impossible to raise these sums of taxation from working people?—I think it would be the view of the Council that it would be very very much more difficult to do so. Impossible, of course, is an extreme word, but I will entirely agree that it would be the view of the General Council that it would be very very much more difficult to do so.

2754. I was thinking not only of amount, but there really is a very considerable variation in earnings from week to week and from year to year even amongst the most highly skilled workers in this country?—Yes.

2755. And you were getting in other ways really quite a large field of industry over which nowadays there are piece-work payments, and earnings are affected by all manner of things, raw materials and one thing and another.—Yes.

2756. *Professor Hicks*: Might I come on to this question of overtime. I would like to ask a question which it seems to me, in my ignorance of some of the facts about the matter, perhaps to be one which we rather want to ask before asking whether high taxation is causing people to be averse to working overtime. My question is whether it is noticeable that during these last few years since the war, when very heavy taxation has been payable on overtime earnings, people are more averse to working overtime for whatever reason than they were before; is there any indication of that?—I would not think so, there is no evidence of it.

2757. You do not know if there is any evidence?—No.

2758. If that is so it rather settles the question without going any further, and those who are going to maintain that view have something to explain.—When I say there is no evidence I mean no authoritative evidence, nothing one can say.

2759. It has not struck you that there have been difficulties about getting people to work overtime for other causes?—No, Sir.

2760. The next point I wanted to go on to was on paragraph 18 where you are talking about weekly wages tax and about the general principle which I do not want to raise; you say one thing which seems to me to go possibly rather far, and I wanted to know whether you really stood by it. You say in the second sentence of that paragraph:—

"Whatever the period of assessment it should be a principle that the same total of tax should be levied no matter in how many instalments the earnings are paid."

That is to say that it is a principle that exactly the same amount of tax must be payable by a weekly wage earner and by a person who is paid the same annual income quarterly or annually. It does not seem to me that that is by any means obvious. I should have thought a very good case could be made for saying the weekly wage earner should pay less than the person who is paid quarterly or annually, but it is an exactly parallel argument to that which was used at the time of the original discussions about the earned income allowance. The original case for the earned income allowance was that an income from property was more secure than an income from earnings which might always be interrupted for any cause, sickness or incapacity on the part of the worker. Is it not true that an income which is paid annually is

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[Continued]

more secure than an income which is paid weekly?—Mr. Murray: To take your last point first if there is an element of insecurity and if in fact there is a period of unemployment when there is no work, that is reflected immediately in the tax paid, but the income is not therefore the same.

2761. The income is not the same.—The income is not the same, exactly. I think it would take us into very deep waters if we were to accept the principle that different amounts of tax could be payable upon similar earnings. We might then have some sort of tread away from the quarterly or monthly payment of salaries to weekly if thereby the individuals were going to pay less tax. I should have thought if the weekly wage earner is to pay less tax than the other he might just as well pay more. I see no moral or ethical ground for saying that it is a better thing in some ways to be paid weekly than to be paid monthly, or vice versa.

2762. I was not suggesting it was better to be paid weekly.—We can of course have our own point of view on that, but we could not rebuff or refute others who held the opposite point of view.

2763. Could you explain to me a little further why you so much insist in that sentence that it should be a principle?—Because each individual should contribute towards the revenue of the State in accordance with his capacity to pay. His capacity to pay can only be measured by his amount of income over a given period which we take as a year, and the second you depart from that principle I do not know where . . .

2764. You depart from it in the income allowances.—In your income tax allowances, yes. I will qualify it by saying the individual's capacity to pay must reflect his liabilities to enter for his dependants, but having qualified it in that way I do not think I can qualify it in another way by referring to the number of instalments in which he gets his income.

2765. Supposing it became convenient for the purposes of administration to have a system of taxation which was administered separately for people paid weekly and people paid over other periods, even if the arrangement were such that the people who earned a given sum weekly paid on their method rather less than the people who earned the corresponding sum annually, would you still object to that?—I think in principle we would be bound to object to it. If we personally did not object I am sure some of the people whom we represent and who will be paid annually or at least quarterly, some of the higher paid employees, would certainly very strenuously object, and we should certainly hear about it.

2766. I am not quite sure about all this.—Mr. Bowers: This is not a point which has been under consideration before, and these are only personal observations.

2767. Mr. Woodcock: May I finish that off for Professor Hicks' benefit, and could I put it this way? Supposing that there was a very considerable change in the income tax system, and that it would be a benefit to introduce as part of a system of simplification for taxation of weekly wage earners. May I take it that the General Council would at least be willing to look at the thing?—Mr. Geddes: Of course they would, but I would have to agree with what Mr. Murray has said, the General Council representing both parties of workers feel it much safer to say that the same man or the man in the same circumstances should pay the same tax whether he earns the money weekly, quarterly or annually.

2768. I am just trying for Professor Hicks' benefit to get rid of this very flat assertion that it should be a matter of principle that the same total of tax should be levied. Would it nevertheless be possible to look at that again?—I think clearly that if for any reason it was considered necessary to suggest a particular system the General Council would clearly have to look at it.

2769. Professor Hicks: One further point on this before we leave it, and that is the particular word "annual" in these circumstances is part of my trouble. I do not quite see why there is anything so sacred about the annual period.—Mr. Jones: It is annual for the purpose of comparison with other incomes. That is the force of the word "annual". It does enable you to make the comparison.

2770. Might I finally go on to ask just another question about social insurance, paragraph 72. I quite see the arguments which you have advanced for the retention of a contributory element in the social insurance system, but I would like to ask you how far you considered that as being tied up with the contribution to social services or social security on the existing plan of anything like the present amount. At present one might say roughly speaking that the worker is contributing a certain fraction, the employer a certain fraction and another fraction is coming from general taxation, some of which at any rate is being contributed by the worker, along the route of income tax rather than along the route of direct contribution. Do you consider that there is anything particularly sacred about the proportions which the worker contributes by formal contribution or by income tax? Is there not a case for saying that the proportion which he contributes by flat sum contribution is not so well distributed, whether it is a tax or not, but it is not so well distributed among the persons paying as the part which is contributed by income tax?—I would think that there is nothing sacred about it, but I think we indicate here one of the difficulties of the non-contributory system, of course, is that there is always a demand and an urge to get more than you are already getting, and unless there is sanction for having to pay for it that it might become excessive. I think these are the reasons why a contribution is a desirable thing in this case.

2771. Mr. Kildor: May I first take up a point which Professor Hicks raised. You would agree, Mr. Geddes, that in times of full employment when there is a general shortage of workers, so that not all the jobs needing to be done can be done, the demand for overtime would be much greater than in slack times, so that one would expect in times of full employment the average hours worked per week in industry to be longer than in times when there is a good deal of unemployment?—Yes.

2772. In times of mass unemployment there would be a tendency to work less?—Yes.

2773. How do the average hours of work in industry compare now with what they were before the war?—From memory I could not answer, but I do not know if my colleagues can.

2774. Am I right in believing that there has been a noticeable shortening in actual hours worked, even when taking overtime into account?—Mr. Murray: There has been a shortening, but there has nevertheless also been a trend over the past three or four years, speaking from memory, towards longer working hours again. You had that sudden fall at the end of the war when I think everybody had the policy of shortening the working week, but since then there has been a definite tendency to increase. I cannot quote you figures, but they are in the Ministry of Labour Gazette for January of this year.

2775. Would it not be right to say that in the last few years people have had more incentive to work longer hours, more to buy in the shops, more things to spend their money on, than in the years immediately after the war, so that again it is a matter of incentive?—Mr. Geddes: I am not quite sure on this, but I think I would be right in saying that one of the factors of full employment is that whilst nationally shorter hours are there, in fact the pre-war hours are being worked but part of the time on overtime rates. It may well be that the real hours worked are not very different today from what they were before the war.

2776. I am referring to the figures from the Ministry of Labour which I think tend to show the total hours worked, both normal time and overtime, averaged out. You would agree, would you not, that although we have no evidence of this, it is perfectly possible that in the absence of P.A.Y.E. the average hours worked would have been longer and that one would have expected them to be longer after the war than they were before the war, but one cannot go beyond that?—Mr. Jones: There is a point at which the worker prefers to take leisure rather than work harder, and it is very difficult to generalise about it.

2777. Does that point not depend on his marginal pay?—To some extent that is one of the factors. Mr. Murray: It depends also upon his consuming capacity and when there were serious shortages at the end of the war that would enter into the calculation.

MINUTES OF EVIDENCE
TAKEN BEFORE THE
**ROYAL COMMISSION ON
THE TAXATION OF
PROFITS AND INCOME**

11

ELEVENTH DAY

Tuesday, 24th June, 1952

WITNESS

MR. H. B. TURLS

The Council of the Stock Exchange

Questions 2801-2929



LONDON: HER MAJESTY'S STATIONERY OFFICE

1952

PRICE 1s. 6d. NET

TERMS OF REFERENCE
(As amended 11th March, 1952)

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages: to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer: to consider the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden fairly among the individual members of the community: to make recommendations bearing in mind that in the present financial situation it may be necessary to maintain the revenue from profits and income; and, in so far as they make recommendations which would on balance entail a substantial loss of revenue, to indicate an order of priority in which such recommendations should be taken into consideration."

NOTE

For the guidance of intending witnesses the Commission published a list of the main heads under which evidence was invited. They explained that the list was not necessarily exhaustive and that witnesses could put in evidence on questions not specifically mentioned, provided that they fell within the Commission's terms of reference. The list is reproduced below.

A. General social and economic questions

1. Is the present system of taxation satisfactory, or could it be improved, in relation to :—
 - (a) incentives,
 - (b) risk bearing,
 - (c) encouraging savings,
 - (d) the control of inflationary or deflationary tendencies,
 - (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment,
 - (f) its effect on the distribution of personal incomes,
 - (g) other economic and social objectives?

These questions can be considered in relation to the taxation of :—

- (i) salaries and wages (P.A.Y.E.),
 - (ii) profits of businesses and self-employments,
 - (iii) dividends and other sources of income.
2. Would it be advantageous to link Income Tax with social security payments and contributions?
3. Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

B. Particular matters

4. Is the taxation net drawn too widely or too narrowly in relation to :—
 - (a) the taxation of United Kingdom residents (companies or individuals) on overseas profits,
 - (b) the taxation of non-residents on United Kingdom profits,
 - (c) the definition of residence, etc.?
5. (a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particular—
 - (b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?
6. Is the basis of computing income from property under Schedules A and B satisfactory?
7. Should the present rules about deductions for outgoings and expenses be altered?
8. Are the provisions for relief in respect of double taxation satisfactory?
9. Should the present system of graduation by means of the exemption limit, personal allowances, reduced rate relief and Surtax be altered?
10. Should the existing differentiation between earned and unearned income be extended or reduced?
11. Are alterations necessary in the rules governing personal and other allowances?
12. Should the rules about the taxation of husband and wife be altered (a) as regards aggregation; (b) in any other respect?
13. Should P.A.Y.E. be altered or abolished?
14. Should the principle of deduction at source be extended or restricted?
15. Should the method of assessment to Surtax be altered, and in particular should it be deducted from salaries?
16. Are any alterations desirable in the system of administration and the functions of the various statutory bodies or persons connected with taxation?
17. Are any changes in the provisions against avoidance and evasion desirable?
18. Is any alteration necessary in the rules governing the taxation treatment of special classes of taxpayers (e.g., public corporations, co-operative societies, charities)?

THE ROYAL COMMISSION ON THE TAXATION OF PROFITS AND INCOME

ELEVENTH DAY

Tuesday, 24th June, 1952

PRESENT:

THE RT. HON. LORD RADCLIFFE, G.B.E. (Chairman)

MRS. VERA ANSTEE, D.Sc.

MR. H. L. BULLOCK

MR. W. S. CARRINGTON, F.C.A.

MR. W. F. CRICK

MR. GEORGE HEYWORTH

PROFESSOR J. R. HICKS, F.B.A.

MR. N. KALDON

MISS L. S. SUTHERLAND, C.B.E.

MR. J. MILLARD TUCKER, Q.C.

MR. E. R. BROOKES (Secretary)

MR. D. G. DAYMOND (Assistant Secretary)

MR. H. B. TURLER on behalf of the Council of the Stock Exchange; called and examined.

MEMORANDUM SUBMITTED BY THE COUNCIL OF THE STOCK EXCHANGE

1. On the general question raised in "A", the Council feel that they have little or no special knowledge. They can only advance the general proposition that, as all investment is a balancing of risk against reward, the seduction of reward almost to vanishing point cannot fail to discourage risk investment.

2. The principal point at which the taxation of industry has a direct impact on the Stock Exchange is in the form in which new capital is raised. The following figures taken from *The Economist* of 6th January, 1951, show company issues by direct public offer in the last four years:—

	Loan Capital	Preference	Ordinary	Total (£ million)
1947	30.6	41.8	114.3	186.7
1948	11.1	23.5	101.6	136.2
1949	11.7	32.2	76.5	120.4
1950	64.5	10.9	58.5	133.9

3. It will be seen that during 1947, 1948 and 1949, the bulk of new capital was raised in the form of Ordinary Shares. This was probably partly due to nationalisation and to the resulting demand, on the part of dispossessed holders, for other equity shares in replacement. In 1950, however, there was a remarkable change, loan capital increasing over five-fold at the expense of Preference and Ordinary—particularly Preference. This was no doubt partly due to the fact that in some cases only temporary finance was needed. But the main cause was, in the opinion of the Council, the incidence of Profits Tax. This not only caused a fall in the issue of Ordinary Shares but also a sharp switch from Preference Shares to notes/debentures for, whilst interest on notes/debentures is an allowable deduction in computing profits assessable to Profits Tax, Preference Dividends are treated as distributed profits and attract Profits Tax at the full rate without benefit of non-distribution relief. On this point the Council suggest that the assessment of Profits Tax on that part of the profits applied to Preference Dividends is inequitable and throws an unfair burden on Ordinary Shareholders.

April, 1951.

SECOND MEMORANDUM SUBMITTED BY
THE COUNCIL OF THE STOCK EXCHANGE

Section B.—Particular Matters

1. Q. 4. Is the taxation net drawn too widely or too narrowly in relation to:—

(a) the taxation of United Kingdom residents (companies or individuals) on overseas profits;

(b) the taxation of non-residents on United Kingdom profits;

(c) the definition of residence, etc.?

Observation:

2. Regarding (a) the Council have no recommendation to make as to the taxation of individuals but are of the opinion that Companies should generally speaking only be taxed on profits earned in or remitted to the United Kingdom.

Regarding (b) and (c) the Council make no comment.

3. Q. 5. (a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particular—

(b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?

Observation:

Capital Gains Tax

4. It is frequently assumed that the imposition of a Capital Gains Tax would produce a large yield for the Revenue and on that account it attracts considerable political support.

5. This assumption, however, is not borne out by experience in the United States for in recent hearings

24 June, 1952]

[Continued]

before the Finance Committee of the Senate the Treasury gave the following estimates:—

(In Millions Dollars)

	Individuals		Corporations	
	Estimated Tax on Capital Gains	As Per cent. of Total Income Tax	Estimated Tax on Capital Gains	As Per cent. of Total Income and Excess Profits Tax
1940 ...	-7	—	-49	—
1941 ...	-86	—	-164	—
1942 ...	68	0.8	42	0.3
1943 ...	256	1.6	62	0.4
1944 ...	354	2.2	100	0.7
1945 ...	721	4.2	214	2.0
1946 ...	893	5.5	270	3.0
1947 ...	644	3.5	210	1.9
1948 ...	528	3.4	190	1.6
1949 ...	475	3.1	180	1.9
1950 ...	790	4.2	270	1.6
1951 ...	890	3.7	330	1.5

6. Any proposals for such a tax, if they are to be equitable, will presumably include the following points:—

1. The tax would be levied on all capital gains of whatever nature other than those on the tax-payer's stock in trade.
2. It would be levied on realised gains only.
3. There would be an offset for capital losses.

7. We are here concerned only with the taxes on profits realised on the Stock Exchange.

8. In considering these it would appear that capital profits might arise from one or more of the following reasons:—

- (a) From a general expansion in the national economy.
- (b) From a fall in the value of the currency unit.
- (c) From profits realised even in a static economy through skillful or fortunate investment.

9. As to (a) in conditions of constant expansion such as obtain in the U.S.A. and Canada, a Capital Gains Tax should be productive of considerable revenue and it is therefore surprising that the yield in the U.S.A. represents in fact so small a proportion of total revenue.

10. As to (b) a capital gain that is no greater than the fall in value of the currency unit is in fact no gain at all and it would seem inequitable to levy a tax when in fact the tax-payer's capital has in real value remained unchanged.

11. As to (c) if we assume a static economy with no rise in real values then one man's profit will be another man's loss and therefore the income obtained from the "gainer" would be offset by a rebate to the "loser".

12. In the United States, where the rates and conditions of the tax have been constantly altered as the result of many years' experience, the main existing tax provisions are that "short profits" (i.e., those realised within six months) are taxable at normal income tax rates while "long profits" (i.e., those realised in over six months) are taxable at 25 per cent. From this it naturally results that investors who have a realisable profit will defer realisation at any rate till after the six months' period, while conversely those who have a loss will realise it before the six months run out. Moreover, in a rising market holders will be inclined to hold on, while in a falling market they will sell to establish losses. Thus a boom of sellers will in a rising market drive prices up, while in a falling market a spate of selling will force prices down. In other words, both booms and slumps will be exaggerated and we understand that this has been the experience in the United States.

13. The *Investor's Chronicle* of 20th October, 1951, contained a most informative article on the Capital Gains Tax in the U.S.A. from which we take the following extract:—

"The most outstanding observation is that revenues from capital gains have been highly erratic; even after the deductibility of losses was restricted in 1934 there was still an overall revenue loss in 1940 and 1941. There was another sharp set-back in 1947 and 1948, though there was still a surplus of revenues. In recent years, revenues have been stable in dollars, but they have never amounted to more than 3 per cent. of the total revenues from income and corporation taxes in any year since 1946. Revenues were obviously higher when the Stock Market was booming and there is also every indication that the more liberal treatment introduced in 1942 has stimulated realisation of capital gains. When the law provided a holding period of 18 months or longer between 1938 and 1941 to qualify under the long-term privileges, revenues were negligible or negative. Many taxpayers can almost indefinitely postpone realisation of capital gains when the rates become prohibitive. All in all, it would seem that capital gain revenues are hardly big enough to make worth while the enormous amount of work put in by taxpayers, accountants and tax authorities."

14. Taking it all in all it would seem that particularly in a static economy a Capital Gains Tax is a "will-o'-the-wisp". It will not, we submit, raise much revenue but it will greatly damage the liquidity of markets and so render still more difficult the raising of risk-bearing capital and the realisation of securities for the purposes of death duties. Further, it must be remembered that in the U.S.A. there is no transfer stamp and yet the revenue as shown above represents so small a proportion of the total yield of income and corporation taxes. Here, with a far less buoyant economy and a 2 per cent. transfer stamp, it is certain that the loss in stamp duty would reduce and might even outweigh the net revenue from a Capital Gains Tax.

15. And this effect will have been achieved as the result of considerable expenditure in collection and of further damage to the national economy.

16. Q. 8. Are the provisions for relief in respect of double taxation satisfactory?

Observation:

17. The Council consider that the present provisions are satisfactory.

18. Q. 9. Should the present system of graduation by means of the exemption limit, personal allowances, reduced rate relief and surtax be altered?

Observation:

19. The Council consider the existing differentiation between "earned" and "unearned" income to be reasonable but would make the following point: At £2,600 a year "earned" income allowance ceases and surtax begins so that at this point a man loses a benefit and assumes a burden. This can only act as a double disincentive. The Council therefore suggest (and the suggestion is strengthened by the fall in the value of the £ sterling) that "earned" income relief should be continued up to a higher figure.

20. Q. 15. Should the method of assessment to Surtax be altered, and in particular should it be deducted from salaries?

Observation:

21. The Council endorse the recommendation of the Committee on the Taxation of Trading Profits that Surtax on fluctuating incomes should be spread at the taxpayer's option by averaging the rate over a five year period.

November, 1951.

24 June, 1952]

[Continued]

THIRD MEMORANDUM SUBMITTED BY THE COUNCIL OF THE STOCK EXCHANGE

Approximate Mean Prices

This list has been drawn up on the following basis:—

(1) The companies selected are the leading companies in their various fields without consideration of whether the shares have risen or fallen during the period under review.

(2) The prices given are the mean between the high and low of each year.

(3) The years chosen are alternately boom and slump years. In 1928, 1936 and 1946 prices were about at their peak and they were at their lowest in 1932 and 1940. The final figure of course is to bring the table up to date.

(4) The price of the nationalised companies' shares has been carried through past nationalisation to the present value of the stock on the basis of the old shares.

(5) The prices are adjusted for bonus issues and for splitting of shares but not for rights issues. It is not possible to adjust in this case. For instance, Shell have had a rights issue at £3 and therefore the rise shown from 100 to 107 ought really to be somewhat greater. On the other hand, Union Corporation had a rights issue at £10 and as the present price is 7.13/16 the existing figure ought to be somewhat lower.

13th June, 1952.

APPROXIMATE MEAN PRICES (Percentage of 1928 Mean Prices are shown in brackets)

Category	Security	1928	1932	1936	1940	1946	3rd June, 1952
British Funds, etc.	24½ Consolidated Stock	552 (100)	663 (119)	861 (152)	724 (130)	952 (171)	961 (101)
Railways (Gt. Britain & N. Ireland)	London Midland & Scottish Railway Co.	654 (100)	154 (24)	254 (41)	164 (25)	304 (46)	224 (34)
Foreign Stocks, Bonds, etc.	Chinese 5% Re-organisation	654 (100)	854 (131)	864 (132)	284 (43)	354 (54)	7 (1)
Banks	Old Loan 1913.	100 (100)	100 (100)	145 (145)	147 (147)	191 (191)	11 (11)
	Midland Bank Ltd.	182/9 (100)	350 (192)	213/9 (118)	150/4 (82)	324/4 (178)	150 (82)
Beereries and Distilleries	A. Guinness, Son & Co. Ltd.	55/9 (100)	45/11 (81)	90/4 (162)	35/10 (63)	83/10 (150)	56/10 (102)
	Distillers Co. Ltd.	6/9 (100)	4/8 (69)	10/6 (150)	7/9 (117)	17/6 (250)	17/5 (250)
Commercial, Industrial, etc.	Associated Portland Cement Manufacturers Ltd.	24/7 (100)	26/8 (110)	47/9 (196)	51/4 (208)	65/10 (269)	94/4 (382)
	J. & P. Coats Ltd.	70/9 (100)	42 (59)	58 (83)	30 (43)	51/1 (72)	41/5 (58)
	Courtauld Ltd.	98 (100)	31 (32)	54 (55)	30 (31)	56/4 (57)	52 (53)
	General Electric Co. Ltd.	30/10 (100)	34/5 (115)	44/7 (149)	47/10 (157)	100 (333)	76 (253)
	Imperial Chemical Industries Ltd.	35/8 (100)	18/7 (52)	40/5 (113)	25/8 (72)	44/1 (124)	40/7 (114)
	Imperial Tobacco Co. (G.B. & I.) Ltd.	95/9 (100)	96/5 (102)	166/4 (174)	96/10 (101)	154/9 (163)	80 (84)
	J. Lyons & Co. Ltd.	32/8 (100)	108/7 (332)	143/1 (439)	78/1 (240)	139/8 (424)	81/5 (248)
	Swedish Match Co.	450 (100)	29/4 (6)	18/4 (4)	5/4 (1)	38/1 (8)	73 (16)
Electric Lighting and Power	Calcutta Electric Supply Corporation Ltd.	49/7 (100)	36/8 (74)	58/7 (118)	20/8 (41)	26/8 (53)	28/5 (57)
	City of London Electric Lighting Co. Ltd.	23/10 (100)	39/7 (170)	36/1 (157)	25/8 (110)	31/4 (137)	28 (120)
Financial Trusts, Land, etc.	City of London Real Property Co. Ltd.	30/9 (100)	15/1 (50)	18/7 (61)	7/11 (23)	15/4 (50)	15 (48)
	Hudson Bay Co.	112/2 (100)	16/9 (15)	30/9 (27)	22/9 (20)	100 (89)	182/5 (162)
Gas	Gas Light & Coke Co.	19/0 (100)	21/8 (115)	27/2 (143)	14/10 (74)	29/1 (153)	19/7 (104)
Insurance	Royal Insurance Co. Ltd.	135/7 (100)	142/4 (105)	195/7 (144)	135 (100)	250/3 (185)	202/4 (150)
Investment Trusts	Industrial & General Trust Ltd.	355 (100)	594 (166)	772 (218)	177 (50)	390 (111)	365 (104)
	Mercantile Investment & General Trust Co. Ltd.	314 (100)	206 (66)	284 (90)	169 (54)	296 (94)	285 (91)
Iron, Coal and Steel	Wm. Cory & Son, Ltd.	38/2 (100)	59/7 (156)	30/9 (80)	70/1 (184)	58/6 (152)	77 (202)
	Vickers Ltd.	13/5 (100)	7/1 (52)	30 (225)	15/8 (117)	24/6 (185)	41/8 (313)
Mines	Union Corporation Ltd.	25/11 (100)	35 (135)	157/4 (625)	127/2 (500)	264/4 (1056)	156/3 (613)
Oil	Shell Transport & Trading Co. Ltd.	84/10 (100)	35/1 (42)	48/7 (58)	55/4 (66)	87/4 (104)	96/7 (115)
Rubber	United Siam Rubber Estates Ltd.	74/4 (100)	24/5 (33)	58/9 (79)	46/7 (62)	43 (58)	32/8 (44)
Shipping	Persimmon & Oriental Steam Navigation Co.	27/9 (100)	12 (43)	17/9 (64)	13/8 (49)	40/3 (148)	44 (162)
Tin	Yokai (Assam) Tin Co. Ltd.	97/9 (100)	27/8 (28)	41/9 (43)	26/8 (27)	44/4 (45)	28 (29)
Average Percentage...		100	69	125	77	131	114
Purchasing Power of £1 for each Year (per £100)		100 (m)	117 (m)	115 (m)	88 (m)	67 (m)	47 (m)

(a) Adjusted for 66½% Capital Bonus in May 1952.

(b) Adjusted for 40% Capital Bonus in October 1938, Splitting of Shares from £1 to 4/- Units in 1947/48 and 50% Capital Bonus in 1950.

(c) Adjusted for Splitting of Shares from £1 to 4/- Units in 1947/48 and 50% Capital Bonus in 1949.

(d) Adjusted for 100% Capital Bonus in March 1928.

(e) Adjusted for 25% Capital Bonus in March 1938.

(f) Adjusted for 30% Capital Bonus in March 1937.

(g) Adjusted for 50% Capital Bonus in September 1951.

(h) Adjusted for 33½% Capital Bonus in December 1932.

(i) Adjusted for Conversion of £100 Ordinary Stock into £29 10s. British Transport 3½% Guaranteed Stock 1978-88.

(j) Adjusted for Conversion of £1 Ordinary Stock into £1 14s. 4d. British Electricity 3½% Guaranteed Stock 1968-73.

(k) Adjusted for Conversion of £1 Ordinary Stock into £1 6s. 6d. British Gas 3½% Guaranteed Stock 1960-65.

(m) Calculated from figures with Base Year 1928 = 100, supplied by The Central Office of Information.

13th June, 1952.

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Mr. H. B. TULLE

[Continued]

EXAMINATION OF WITNESS

2801. Chairman: Mr. Tulle, you have come to represent the Stock Exchange?—Yes.

2802. You are Vice-Chairman of the Council?—No, Sir; I am on the Council, I am not Vice-Chairman.

2803. We are grateful to the Stock Exchange for the papers they have put in to us, to which, of course, we have all given our attention. There is not, probably, very much needed by way of questions to elucidate any points which arise out of what you said, but I wish you would just tell me on your third document, the list of securities in the different years, what the use of this document is for purposes of your argument in your other papers? What are we to read from it?—As the question was for or against a capital gains tax I thought it would be interesting to see what had been the capital losses and gains over a period, and I took as the beginning 1928, which of course was a year of high prices, and followed these various shares, which are representative of the Stock Exchange as a whole, followed them through the various years through the slump of 1932 to the relative boom or the better markets of 1936, and again the war slump of 1940 and again the boom price of 1946. We thought that it might be of use to the Royal Commission to see just what did happen to an investment over that period of years, and the result a small gain of 14 per cent. over the 24 years, though of course that is taken from a fairly high starting point. Then, below that, we have set out the purchasing power of the pound, the official purchasing power of the pound for each of those periods starting with 1928.

2804. Is this right, then; we see from it, taking the series of years you have taken, that the experiences of the different stocks have been very unlike each other?—Yes, very great differences, Sir.

2805. Of course, from the point of view of the Stock Exchange, it is a very limited list but you put them forward as representative of their class?—Yes, they have not in any way been chosen to suit a case, but merely the leading shares in all the different categories and, of course, in the case of commercial and industrial shares there are several more than in other categories because there are so many more of them. Some companies that might have been put in have not been put in owing to the fact that amalgamations and changes and so on have made it difficult to follow them through.

2806. So there are very large differences in their individual experiences?—Yes, Sir.

2807. We can see if you start with 1928, we can take other years, of course, if necessary, what is the measure of the gain over a period of 24 years. That shows, if you are considering a capital gains tax applied to any one year, that you will have ups and downs in the subject of the tax?—Yes, Sir.

2808. And lastly you have added the comparison with the purchasing power of the pound, which I suppose bears on the argument that is thrown up that there is a difference between monetary gain and real gain for this purpose?—Yes.

2809. Thank you. Now, just one or two questions on your other papers. First of all, will you turn to your first paper where I think you draw attention to a point about the way of calculating profits tax from the point of view of preference dividends, which is quite familiar to the Commission from various sources. One attention has been called to it, of course, and you draw attention to the variation, over the years 1947 to 1950, of the distribution of losses offered directly to the public through the medium of the Stock Exchange as between loan capital, preference and ordinary?—Yes.

2810. What is the lesson contained in that? I wish you would clear up the following point because it has arisen once or twice. When we are dealing with the figures of the direct offers to the public made through the Stock Exchange that, of course, is not representative of capital required for industry as a whole, is it?—I should have thought it was, Sir.

2811. What I want to find out is this. Of course you have fairly strict requirements now as to what qualifies an issue to take place?—Very strict, yes.

2812. That must mean that it is more difficult, is it not, for the new venture to go through the medium of

the Stock Exchange for capital from the public than for the established venture which can show a record of performance behind it?—When you say established venture you mean a public company which has its accounts well known to the public for a period of years? But we have a great many flotations on the Stock Exchange of companies previously unknown to the public but nevertheless which can put up a period, as, indeed, they are required to if they have been so long in existence, of at least ten years of results.

2813. That is, a business with a history that can be gone into?—There are a great many cases, nowadays, where you have private family companies turning themselves into public companies in anticipation of death duties.

2814. Yes. I was wondering how far we ought to look of the medium of the issue through the Stock Exchange as a way of obtaining capital from the public for the really new ventures, the unproved business. Do you get much of that to-day?—Very little, Sir, I think, except of course in mining, but otherwise I think you get very little. It is better that the individuals who are lacking a new process or a new idea should try it out themselves and bring it to a certain point before inviting the public to subscribe money to it.

2815. That is rather what I wanted to explore with you. The issue to the public through the medium of the Stock Exchange is not the normal way of finding finance for that kind of venture?—Not in the initial stages of the venture. Except, as I say, you do have, of course, new and undeveloped gold mines and a certain number of others but, generally speaking, a new process would be financed privately on a small scale until it was brought to a point where it could have some record to put before the public.

2816. I suppose very often the mining venture if it makes an issue to the public has very strong backing from established mining houses?—Backing in the sense of the mining houses' name, but of course no guarantee. They have to take their risk on a successful outcome.

2817. Just turning for a moment to the points about capital gains tax as a project, you have drawn our attention to some facts in connection with American experience. There is a point you make and I would just like to see if I have understood it. At the last sentence of paragraph 12 of your second document you say:—

"In other words, both booms and slumps will be exaggerated and we understand that this has been the experience in the United States."

That means that there has been an experience there, according to your information, which shows that the existence of the capital gains tax in its American form has contributed to the stock market booms and slumps?—Hm, I think, accentuated. I would not say contributed to nor caused them, but I think it must tend to exaggerate them because of the temptation to a man to establish a loss, to sell the shares that show a loss and retain shares which show a profit, thus establishing a capital loss and not a capital gain. I had reading the various reports of Congressional Committees and so on that I am bound to say some people say one thing and some another.

2818. I was wondering whether I had understood your reasoning, that, if you impose the capital gains tax in the American form or something like it, you have added by the tax a special reason for a man wishing to take a loss and also added a special reason for him not wishing to take a profit in any one year. Is that right?—Yes, Sir.

2819. I am not quite clear why the addition of those two elements should help to accentuate a stock market boom or slump. They would hold him back from one point of view and push him forward in another?—I should have thought if you had a weak, a falling, market that there would be a tendency on the part of people to realise a loss which would tend to make the market weaker by sales. On the other hand if you get a strong market, a boom market such as they had in 1929 in the United States, people would be loth to take their profits on their shares which have shown them a large profit because it would result in their being mulcted of a considerable amount for the capital gains tax. And, of

24 June, 1952]

Mr. H. B. TUNAR

[Continued]

course, the revenue from the capital gains tax was enormous in 1928, and 1929 and the loss was tremendous in 1931, 1932, and 1933, and I should think that is a natural—must be a natural tendency that would arise from the imposition of the capital gains tax.

2820. Yes. I suppose in the case of market movements that you are describing there are a great many more potent influences that would lead to sales?—Undoubtedly. I merely mean that the capital gains tax tends to accentuate the fall and the rise.

2821. When you go on, in paragraph 14, to refer to it as a "will-o'-the-wisp" in a static economy and being likely greatly to damage the liquidity of markets, you are thinking there of the same point, adding another deterrent to prevent people coming into the market and taking their natural gain?—At an earlier stage than that, Sir. I think it would deter people from taking risks, particularly as, for instance, on new flotations and so on where it may be worth taking a risk to take a share, say, in the initial flotation of it. I think to some extent that speculative risk has been affected by the two per cent. stamp duty instead of one per cent. which, of course, has checked a good deal, and now I think if you put a capital gains tax on top of that it will make it still more difficult to raise equity capital. It seems to me that the worst feature of a capital gains tax would be that it must operate to check the provision of risk capital.

2822. Yes, I see.—It is not so easy now as it used to be to find buyers for new risk capital that comes on the market. The risk has to be taken somewhere if a placing is to be made successfully. Owing to the depletion of their capital through death duties and the inability to save under the continuing high taxation, jobbers are no longer able to take as large risks as formerly, so that a larger proportion of the business has to be done in other quarters which would be subject to a capital gains tax—jobbers of course are already taxed on their capital gains—so that such a tax would restrict or restrain this very necessary business.

2823. You are speaking of the function of the jobber?—The function of the jobber now. Many years ago you could probably go to the market and get the jobbers to say "All right, we will take £100,000 or £200,000", but nowadays they cannot do that; they have not got the capital and they take perhaps £20,000 instead of £200,000. The broker has to go somewhere to do the business. He may go to an investment trust or an insurance company or possibly, in some cases, to a private individual and say "Now, look here, if you will take £20,000 of these shares—we want to make a market in them, we must have them available to the public at so and so price—and offer us back some of the shares at a shilling profit—or whatever it may be." At present that can be done and it is done, but if you put a capital gains tax on then you will cut straight at that method of getting risk capital.

2824. I think that clears up the questions I wanted to put. I will ask my colleagues if they have any questions.—I think I wrote to the effect that in paragraph 5 of the second document in (a), (b) and (c) we should, of course, have added an extra reason which is the change in money rates. Of course it is obvious, but we ought to have put it in.

2825. The change in the interest rate?—Yes, in the interest rate.

2826. Mr. Millard Tucker: In paragraph 2 of your second document, your observation (a), you say the Council have no recommendation to make as to the taxation of individuals, but are of the opinion that companies should generally speaking be taxed only on profits earned in or remitted to the United Kingdom. It is not that you are indifferent to individuals? I suppose it is just that you do not wish to make any particular recommendations about them, is it?—As a Stock Exchange we are not directly concerned with the taxation of individuals generally, but I would refer you to our observations under headings 9 and 15 dealing with the differentiation between earned and unearned income, and with the method of assessment to surtax.

2827. Yes. Concerning this observation of yours that companies should, generally speaking, be taxed on profits earned in or remitted to the United Kingdom, there are individuals and partnerships as well who are earning income abroad?—They would be taxed.

2828. Yes, so are companies, but you say that the taxation of companies' foreign profits should be restricted to those profits which are remitted to this country?—Yes, Sir.

2829. Could you tell us why you say that? You will bear in mind that in most countries of importance now there is a double taxation agreement?—Yes.

2830. And the effect really is to make the company bear the higher of the two countries' taxes?—Yes.

2831. Why do you say that the taxation of an English company should be restricted to the profits it remits here. What is the ground of it?—If that had been part of the law would we not have avoided the transfer abroad of these very important copper companies which were paying such enormous taxation in Britain and have therefore been compelled to transfer to Northern Rhodesia? Should we not have stopped that if we had only required them to pay tax on the profits remitted?

2832. That is the kind of ground you have in mind?—Yes, Sir. I think it is a very serious thing for this country to see these companies, that have started in this country at a time when we financed so much of the world, to see them being driven slowly overseas by the level of British taxation, and to see that the Treasury feels bound to take up an attitude of, shall I say, physically restraining them. It would be much better if something could be done, I do not know if it could or not, to make it reasonable for a company to remain in the United Kingdom. And, of course, Sir, you will remember that what you were saying about double taxation does not apply to all countries.

2833. No.—There is taxation on British sterling companies operating in India.

2834. The agreement with India is still in the process of negotiation, but in the main the more important countries of the world are now covered.—They are covered, yes, Sir.

2835. There are still some left out, we know, but progress is going on gradually. I only wanted to see what your reason was. You had not given one, you merely asserted, and we wanted to see what the reason was.—Even allowing for the double taxation agreements that are in existence today, would not Rhodesian copper companies be paying far more taxation to-day if they had not transferred?

2836. Yes.—That is what we feel should be the national interest be remedied if it possibly can be.

2837. You make that point perfectly clear, Mr. Turle, that is all I wanted to ask you. In the case of a company operating both in this country and abroad do you still say that that company, which could not very well move itself for practical reasons, would have to be excused tax on any foreign profits not remitted here?—I would rather like to think about that. I should have thought yes; I should have thought it would be in the national interest to do it. Otherwise there is a danger that the foreign and would be hived off and lost to this country altogether.

2838. The same reason as the other one?—Yes.

2839. Thank you. Do you make any distinction between private companies and public companies in this respect? When I say public companies I mean what you would think of as a public company, one in which the public is substantially interested?—I should have thought the principle would have been the same in each case but I know little of private companies.

2840. You are now speaking almost entirely of the companies in which the public are substantially interested?—Not from the point of view of the public interest but mainly from the point of view of the Inland Revenue interest, which I suppose would apply equally to private and public companies.

2841. Yes. Then in paragraph 6 you say:—

"Any proposals for such a tax, if they are to be equitable, will presumably include the following points:—

— (1) The tax would be levied on all capital gains of whatever nature other than those on the taxpayer's stock in trade."

Of course, the stock in trade will bear the tax on its

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[Continued]

income. She is at any time entitled to change the form of investment she holds. If she had bought that preference share when she bought the consols at 60 it would have gone up just as much and there would have been no question of selling it.

2883. *Mr. Carrington*: Apart from the one point you raised in your first memorandum in regard to profits tax, your two papers do not bring out any other points, I think, in regard to company taxation, do they?—That and the taxation of overseas profits.

2884. Have you any points that you wanted to bring out additional to those, or do these represent the sum total of the points on the question of company taxation?—On the question of company taxation there are the two matters I have just mentioned. We tried to confine ourselves to matters included in the Heads of Evidence and to points on which the Stock Exchange as a institution is in a position to give evidence.

2885. *Sir Geoffrey Heyworth*: When was the transfer stamp duty raised from 1 per cent. to 2 per cent?—August 1st, 1947.

2886. Has it been noticeable that that had any effect on the amount of Stock Exchange business?—Yes, it has, but it is a little difficult to get the exact effect because more or less coincidental with the increase in the transfer stamp duty there was a general weakening of the market. I have got here the figures for transactions over the period of years from 1946—or rather when I say transactions, the number of transactions which have been notified which is not necessarily the whole lot but more or less the whole lot. The number reached 2,300,000 in 1946-47. Then in 1947-48 it fell to 2,300,000, in 1948-49 1,700,000 and 1949-50 1,600,000—and at the moment it is running at the rate of less than 1,500,000.* I am afraid it is not possible, as so often in these cases, to say this or that of the different influences at work was the sole cause of the fall.

2887. Would you think that damage is caused by discouraging a particular type of Stock Exchange operator; it obviously does not affect the general investment field, I take it?—I think it discourages two types. In the first place it discourages the speculative purchaser. It also has discouraged and checked a lot of business which was rather useful of its type, as for instance in the purchase and sale of debentures with a short date. If you have a holder who has a debenture, say it is a 6 per cent. debenture due in three or four years and standing at 108, it might pay him or the company to sell that and take a small capital profit which he would not get if he held the stock to maturity. On the other hand, it will very likely pay pension funds and life insurance companies to buy that because they are not affected. All that sort of business has gone entirely, and I think it is a pity because it was a useful business that was of some value and kept the market, as I say, more fluid.

2888. Would you say, generally speaking, that there is not a great deal of sorrow at the loss of the first type of business but there is of the second type?—Yes.

2889. On the other hand, you cannot suggest any instrument which would be sufficiently selective so that it would check one and not the other?—We did ask one or two of the heads of the Inland Revenue to lunch with us some years ago to discuss the matter, and we did put up various suggestions on the basis of a graduated tax according to the final date of redemption. I have forgotten who they were now, but they finally told us they did not consider it practicable to do so. It could I think be done actually; it is a pity to render the market static in the last two or three years of a debenture.

* The witness subsequently put in exact figures of the daily average of stocks, as follows:—

1947—Seven months, January–July	11,337
Five months, August–December	7,548
1948	7,423
1949	7,421
1950	6,869
1951	8,866
1952 (January–June)	5,740

† The witness subsequently wrote to the Commission to say that he misunderstood this question; he had thought that it referred to sorrow on the part of institutional investors, and wished to add to his answer the words “so far as institutional investors are concerned”.

2890. Would you think that the discouragement that this extra 1 per cent. has been to the speculative type has really meant that those people, who are just plying around on the Stock Exchange, and who you may say tend to draw attention to capital gains taxes, are sort of pretty small proportions?—Very I think, yes.

2891. *Mr. Kellor*: You have just given some figures to Sir Geoffrey about the number of transactions on the Stock Exchange in various years. Is there any estimate about the value of those transactions, in other words the value of the stocks and shares that changed hands through the Stock Exchange in successive years?—No, Sir.

2892. So you do not know how these figures would compare?—No, not at present, we have not any figures of that kind available now.

2893. Obviously the proposition could not be proved, but you would say on the whole that the 2 per cent. stamp duty discourages the frequent buying and selling of shares?—Certainly, yes.

2894. It reduces the volume of the business?—Yes, it reduces the liquidity of markets, too.

2895. This is a point I was just going to ask you. Is a reduction in speculative activity a bad thing or a good thing from the point of view of the steadiness of the market?—I think it is very difficult to answer that question directly. If you have a market in which the general public gets very excited then possibly speculative buying puts prices to a level which is not reasonable, but, on the other hand, speculation is of use in maintaining steadiness of the market because if there are many sellers in a weak market there is then somebody who will say “These are cheap, I will buy them and chance making a profit.” It checks the decline, whereas if the market is simply dependent on pure investment, the decline will go considerably further. The speculator I think tends to restrict the rise and fall by buying shares when the general feeling is to sell them and by selling shares when the general feeling is to buy them.

2896. In the Stock Exchange you have some very active shares in which there is a large volume of business done, and also shares in which there is very little business done, or shares which are only put on provincial markets, which is presumably small business. Did you ever make any study or consider whether the very active shares, in which there is a large volume of business done, are more steady in price, taking a number of years, I do not mean from one week to the next, than the shares in which there is very little business done, or is it the other way round?—I should have thought there was not much in it except that in a period, as for instance now, when things are rather depressed there is always a market for the big shares and you can say how much they have fallen. For instance, from 55s. to 40s., then you know exactly. You cannot judge small shares like that because you go to sell them and you simply cannot sell them. Take the case say of some good but little known company shares put on the market at about 13s. They have fallen to 10s. and some estate wants to sell, but you cannot get a buyer; you may eventually find somebody to pay 7s. 6d. for them. That gives a completely false impression. If that deal goes through at 7s. 6d. you say the price of the share is 7s. 6d., but if that deal had never been done the price would still appear to be 10s. and there would be any business either way to test the market. I do not think I can answer your question.

2897. Your answer really is that a speculative attitude in regard to a share creates a market and checks the decline because speculators take up shares; but, on the other hand, when you come to think of the rise, you would agree that the more speculation there is the more shares will in fact tend to rise?—I think we are on two different things. I thought you were talking of what one might call the professional speculator. He will tend to go against the line of the ordinary investor. He will tend to sell when people are buying and buy when they are selling and therefore he will check the movement in both directions.

2898. I am merely trying to find the answer to the question that if you discourage speculation, whether it is done by way of stamp duty or whether it is done by a

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[Continued]

capital gains tax, can one say the discouragement of speculation would increase the ups and downs of the market?—Certainly, because your buffer is not there to check the market in either direction.

2899. The pressure may not be there either against which you need the buffer, if you see what I mean. The pressure may also come from speculation.—The pressure may come from what you might call amateur speculators but there is frequently a definite tendency with a market such for instance as to-day when the tendency of the market is definitely downwards. The ordinary man who has perhaps £100 to invest or something of that sort is not investing at all now. Therefore it is very hard when a seller comes along to find an investor who wants to buy. That is why I think what you might call the professional speculator is of value because he does buy the stock when no-one else wants to, or vice versa.

2900. You say there were roughly 2 million transactions to the Stock Exchange in a year. It is very difficult to assess the significance of these figures if one does not know what is the value of an average transaction. Can you say, however, ever so roughly, how much of it represented the investment of current savings or the switching operations of ordinary investors and the activities of professional speculators. I am trying to suggest to you that maybe it is true that the bulk of these transactions are speculative in character but they come from outside rather than being prompted by the professional seller.—On the contrary I think the enormous bulk of these transactions are investments, the enormous bulk of them.

2901. Could you define "investment" in this connection?—I simply mean the man writing to his broker and saying "I have £500 and I want to make an investment", or something of that sort.

2902. That does not mean an investment of current savings.—It may or may not. He has received £500 from some source. On the other hand of course you have a tremendous lot of things like "I have bought a house and I want to sell something to pay for it", and that is the great bulk of the Stock Exchange business I should say, ordinary small investments and sales.

2903. If the business comes from ordinary people, maybe smaller people giving an order to their broker to buy some shares and sell some other shares, that is still some sort of a speculation, is it not? It is not necessarily anything to do with the question of channeling the flow of current savings into capital expenditure.—I think it is as you like to define it.

2904. Discouragement of that type of activity would maybe have a steady influence, not necessarily a de-steady influence. You would not like to say one way or another?—Could I have it over again? That the discouragement of that type of man who wants to change his investment . . . ?

2905. Who buys one share and sells another; if you discourage this activity, whether by stamp duties or some other means, that may actually steady the market?—I do not think so. I do not think it would have much effect one way or the other in steadying the market.

2906. If it has not got much effect one way or another, I suppose there is not very much in the argument either that a capital gains tax . . . —Wait a minute, you are using speculation and speculators in two different senses it seems to me. There is what you might call the professional speculator. He tends in my opinion to iron out the corrugations because he is ready to go against the general tide.

2907. Somebody must cause these corrugations which the speculator is trying to iron out. Who causes them?—I suppose it is almost entirely psychological, based on the news of the day, on the news of the Budget, the foreign news and so on. In certain periods such as for instance now the public you might say are selling. In other times when there is a feeling of prosperity about the public are buying.

2908. That is precisely what I want you to consider. The public sells when it thinks the market is going to fall and buys when it thinks the market is going to rise and both these activities cause the market to fall or to rise, is not that right?—Yes, I think that is true. I suppose, shall I say, the initial impetus is something like the

financial situation of the country or the news or fear of war, that sort of thing, and that does precipitate people into selling.

2909. The people who sell because they think shares will fall and they may make a profit later. Why do the ordinary public sell in response to bad news?—I think what you frequently do get is a letter from a man who says "The way things are now I had better be liquid and I should like to sell some shares."

2910. In other words, if these people did not think they could buy these shares back later on at a lower price it would not be worth their while to sell in the first instance, would it?—No, except of course I would not restrict myself to those shares. They presumably think the market as a whole will be lower in time and also, apart from the question of the market being lower, you frequently find people who want to feel they have money in the bank so that if they have any extra expense they will not be forced to sell shares. They like to have a certain amount of liquid . . .

2911. But when they think the market is right they are willing to put up with less liquidity! That means the ordinary public do buy with speculative intent. That is what I am asking you to agree with. They buy when they think the market is rising, out of cash, liquid resources or anything they have in the bank. When they think the market is falling they sell shares and keep money in the bank. Then anything which would discourage the public from buying and selling shares frequently may diminish those forces which make the market itself rise and fall?—But this public you are speaking of does not buy and sell shares frequently. It is just the tendency of a man selling here and there and the absence of buyers in a depressed market that causes the shares to fall. It is not the huge activity of numbers of small people selling or, on the other side, numbers of people buying and speculating for a rise, it is just the tendency in bad times . . .

2912. It was your suggestion, it was not mine, that the bulk of these two million transactions in the Stock Exchange represent purchases and sales by the public at large?—Yes, but the enormous bulk of these were investment transactions.

2913. I thought it was your suggestion also that the bulk of these transactions, I am not saying that the same individual may buy or sell shares with any great frequency, does come from the public who feels this is the time to sell shares and go into cash or alternatively it is the time to buy shares.—That is so.

2914. Anything which might keep the public at large tied to their investments more steadily and not to sell on bad news and not to buy when there is good news would have a steady influence on the market presumably?—I do not know that it would. If a man decides that he wishes to be more liquid and to sell some of his shares I think he will sell his shares.

2915. Not if he makes a big loss in doing so. Suppressing the stamp duty were 20 per cent. instead of 2 per cent. and you sell a share, to get it back again you may lose 20 per cent. of your capital. Would not that be a very great discouragement?—Yes, that certainly would.

2916. I do not wish to keep on with this point, but I merely wish to suggest that discouragement to speculation, whether done by way of stamp duty or by other means, may have a steady influence on the market and not the influence which you suggest in your paper. May I ask a more general question? As far as I understand the paper submitted by the Stock Exchange, you would not in general disagree that there is a case for a capital gains tax looked at purely from the point of view of equity? Or do you disagree?—I do not think there is anything immoral in a capital gains tax in theory, but I think it is inequitable if you are going to reckon your victim's capital gain in a currency that he never originally made the purchase in, and under different interest rates. If you are going to tax a genuine capital gain it seems to me there is nothing wrong with it, but I think it is unfair to tax a capital gain that is merely a nominal capital gain.

2917. Questions of equity essentially relate to equity between different individuals, it is a purely relative matter, would you not agree? It is a question of whether some particular man A is unjustly treated in relation to

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[Continued]

some other man B, and if you look at it in that way, is it not true to say that even in times when the value of money is changing, as a result of not having a capital gains tax some people are much more heavily taxed than other people in relation to the same criterion of capacity to pay?—Yes, in part.

2918. Take the man who invested in gilt-edged, he would not have any capital gain as a result of the fall in the value of money.—No, I quite agree, but it is inherent in the fall in the value of money that the half-crown in your pocket is worth less, your bank balance is worth less and your Government securities are worth less.

2919. Is not that a reason for giving a special relief to a man whose income has not increased because it was all in gilt-edged securities?—I do not think so. What relief are you giving? I do not know whether you are giving much relief to your gilt-edged holder, because it seems to me that the American experience does not indicate that you make much out of a capital gains tax, but apart from that I do not see why you should remove from a man his freedom to buy money if he likes or to buy things if he likes, including in "things" equity stocks.

2920. But you would not suggest that the people who bought gilt edged stocks did so in the full knowledge of the risks and the dangers to which they thereby exposed themselves in times of inflation?—No, they buy what they think is the safest investment.

2921. Supposing you take two people both in gilt edged, and one buys 2½ per cent. consols and the other buys some other stock with clear redemption date. I believe you have on the Stock Exchange a concept of a "year to redemption" which takes into account the fact that it has to be redeemed at par at a definite date in the future. Would you not agree that that part of the yield in the case of a dated stock which is due to appreciation in the value of stock between the date of purchase and the date of redemption is just as much part of the income of the investor as the actual nominal interest that is being paid on it?—Yes, it is ultimately.

2922. But so far as the present tax is concerned the treatment is different?—Yes.

2923. So you would agree it is inequitable?—No, I would not agree it is inequitable. After all, you can choose for yourself. If you wish to get a high running yield you choose your 2½ per cent. consols, or whatever it is, and if you wish to take a small running yield in consideration of tax-free profit you buy the 2½ per cent. Savings Bonds we will say. I do not think there is anything inequitable between those two. One man could choose one and one man could choose the other.

2924. It depends on the way you look at it. If you take a man who pays surtax and pays tax at a very heavy marginal rate he will derive advantage from the fact that he can invest in securities which have a low nominal value and a high redemption value.—Certainly.

2925. Chairman: Of course, we must not hope to convert Mr. Tulis completely.

2926. Mr. Kaldor: My Lord Chairman I feel again I have taken too much time, but may I ask one or two brief questions arising out of the paper. You say in paragraph 9 of this document that conditions of constant expansion, at least the implication of the sentence is that the conditions of constant expansion which obtain in America and Canada may justify a capital gains tax.—I did not say "justify". I merely said "would be productive".

2927. You would definitely say that in this country, in fact I think you did say that before, we are not a progressive economy as against these others?—You are as economist and I am not, but I should have thought not.

2928. I thought you said in answer to some question that you did not believe that we in this country are in effect maintaining our capital intact?—That was the conclusion of "The Economist", you may remember the article?

2929. I would not regard "The Economist" necessarily as an authority in this matter, but would you agree that in Britain more real capital is now being created in industry than there was in the years before the War, or would you say there was less?—I think you are taking me beyond my role, Sir.

Chairman: Thank you very much, we are very grateful to you for your helpful answers.

The witness withdrew.

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MINUTES OF EVIDENCE **12**
TAKEN BEFORE THE
ROYAL COMMISSION ON
THE TAXATION OF
PROFITS AND INCOME

TWELFTH DAY

Friday, 27th June, 1952



WITNESSES

MR. R. F. HARROD, F.B.A.	-	-	-	-	-	-	-	<i>Questions 2930-3113</i>
MR. P. J. D. WILES	-	-	-	-	-	-	-	<i>Questions 3114-3250</i>
MR. T. BALOGH	-	-	-	-	-	-	-	<i>Questions 3251-3361</i>



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1952

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TERMS OF REFERENCE

(As amended 11th March, 1952)

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages: to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer: to consider the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden fairly among the individual members of the community: to make recommendations bearing in mind that in the present financial situation it may be necessary to maintain the revenue from profits and income: and, in so far as they make recommendations which would on balance entail a substantial loss of revenue, to indicate an order of priority in which such recommendations should be taken into consideration."

NOTE

For the guidance of intending witnesses the Commission published a list of the main heads under which evidence was invited. They explained that the list was not necessarily exhaustive and that witnesses could put in evidence on questions not specifically mentioned, provided that they fell within the Commission's terms of reference. The list is reproduced below.

A. General social and economic questions

1. Is the present system of taxation satisfactory, or could it be improved, in relation to:—
 - (a) incentives,
 - (b) risk bearing,
 - (c) encouraging savings,
 - (d) the control of inflationary or deflationary tendencies,
 - (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment,
 - (f) its effect on the distribution of personal incomes,
 - (g) other economic and social objectives?

These questions can be considered in relation to the taxation of:—

- (i) salaries and wages (P.A.Y.E.),
- (ii) profits of businesses and self-employments,
- (iii) dividends and other sources of income.

2. Would it be advantageous to link Income Tax with social security payments and contributions?
3. Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

B. Particular matters

4. Is the taxation net drawn too widely or too narrowly in relation to:—
 - (a) the taxation of United Kingdom residents (companies or individuals) on overseas profits,
 - (b) the taxation of non-residents on United Kingdom profits,
 - (c) the definition of residence, etc.?
5. (a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particular—
 - (b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?
6. Is the basis of computing income from property under Schedules A and B satisfactory?
7. Should the present rules about deductions for outgoings and expenses be altered?
8. Are the provisions for relief in respect of double taxation satisfactory?
9. Should the present system of graduation by means of the exemption limit, personal allowances, reduced rate relief and Surtax be altered?
10. Should the existing differentiation between earned and unearned income be extended or reduced?
11. Are alterations necessary in the rules governing personal and other allowances?
12. Should the rules about the taxation of husband and wife be altered (a) as regards aggregation; (b) in any other respect?
13. Should P.A.Y.E. be altered or abolished?
14. Should the principle of deduction at source be extended or restricted?
15. Should the method of assessment to Surtax be altered, and in particular should it be deducted from salaries?
16. Are any alterations desirable in the system of administration and the functions of the various statutory bodies or persons connected with taxation?
17. Are any changes in the provisions against avoidance and evasion desirable?
18. Is any alteration necessary in the rules governing the taxation treatment of special classes of taxpayers (e.g., public corporations, co-operative societies, charities)?

MINUTES OF EVIDENCE TAKEN BEFORE
THE ROYAL COMMISSION ON THE TAXATION OF
PROFITS AND INCOME

TWELFTH DAY

Friday, 27th June, 1952

PRESENT:

THE RT. HON. LORD RADCLIFFE, G.B.E. (*Chairman*)

Mrs. VERA ANSTY, D.Sc.
Mr. H. L. BULLOCK*
Mr. W. S. CARRINGTON, F.C.A.
Mr. W. F. CRICK
Mr. J. E. GREENWOOD
Sir GREGORY HAYWORTH
Professor J. R. HICKS, F.B.A.

Mr. N. KALDER
Miss L. S. SUTHERLAND, G.B.E.
Mr. J. MILLARD TUCKER, Q.C.
Mr. G. WOODCOCK
Mr. E. R. BROOKS (*Secretary*)
Mr. D. G. DAYMOND (*Assistant Secretary*)

* Present only for the evidence of Mr. R. F. Harrod, F.B.A.

Mr. R. F. HARROD, F.B.A.: called and examined.

MEMORANDUM SUBMITTED BY MR. R. F. HARROD, F.B.A.

Plan for Altering the Incidence of Progressive
Taxation on Lower Incomes

1. In considering the effect of Income Taxation upon incentive, the fundamental distinction is between the effect of the total tax that has to be paid and the effect of the rate of tax that falls on marginal earnings must be drawn. It may be that higher overall taxation in many cases (though not in all) stimulates to further work. This is quite consistent with the view that the incidence of a high rate of tax on the reward of additional efforts acts as a strong disincentive to the individual to make those efforts. This affects alike factory operatives and those in the higher income brackets.

2. Having regard to what follows I should like to disclaim the view that, as a general rule, it is the duty of the central government to adopt, or of the economist to advise, measures likely to make people work harder. In general we should not be biased in favour of hard work. If the individual prefers lighter effort and more leisure, it is for him to choose freely; there is no special virtue in a large volume of output achieved by more effort than the individual chooses to make. It may be generally agreed, however, that present conditions are rather special. We have the combined incidence of the need for post-war reconstruction, of the parliamentary decision that more resources are to be employed on various social services to be compulsorily granted and enjoyed, and of the need for a greatly increased defence effort. This combination of circumstances means that unless everyone does work as hard as possible, great evils will fall upon our economy (inflation, etc.) which we know quite well that the citizen will not like. Furthermore, the plan that I have the honour to submit does not increase the stimulus to harder work beyond the point of offering to each individual that he receive in return for it value equivalent to the value to the society of his efforts.

3. A distinction must be drawn between the short run effect and the long run effect of the incidence of a high rate of taxation for marginal earnings on the incentives and efforts of those subject to it. The short run effect will be particularly adverse in the case of those who are enjoying a higher standard of living than they have been accustomed to in the fairly recent past. This now applies to certain sectors of the population at the lower income levels. If they can have what they are used to and a little more, without making extra efforts, then a high rate of taxation on the fruits of those extra efforts will be more than usually discouraging. The long period effects

are to a large degree independent of such recent changes, and it is for this reason, among others, that I hold that we should be particularly anxious about the long period effect of high marginal taxation on the higher income brackets.

4. I am concerned in this submission with the Income Tax. It should be noted, however, that the effect of indirect taxation is to increase the disincentive effect of the high marginal rate of Income Tax. If conventional necessities are held at fairly low prices while those articles that verge into the category of luxuries are heavily taxed, this also makes the incidence of taxation on marginal earnings much heavier than its incidence on earnings generally. In the case of the indirect taxes, we cannot make much change in the existing system, since it is most important that there should be high taxation on consumers' durable goods which belong to the category of semi-luxuries. This fact makes it all the more incumbent upon us to consider carefully any method available for altering the pattern of the incidence of Income Tax.

5. No doubt the Commission will have had evidence from those directly concerned of the discouragement to effort of existing high marginal rates on wages. Economists in Oxford who have been studying these matters have had the benefit of much evidence of this kind. There appears to be a more than ordinary lack of eagerness to work overtime. By the same reasoning, it may be assumed that piece rates and bonus schemes are not as effective as they would otherwise be in inducing greater exertions. We have also the phenomenon of absenteeism wherever that is consistent with continued employment.

6. In the scheme that I shall submit, I shall confine myself to the category of wage earners (and lower salary earners). This is of special importance for our short period problems. I believe that a similar scheme could in principle be applied to higher income brackets also, although it might be more complex and difficult to work out. None-the-less, in view of the long period evils that may flow from the present system, thought should be given to a reform on similar lines to be applied to higher incomes.

7. As prelude to my submission I beg leave to go back to first principles. Two lines of thought lead to the justification of progressive taxation. (i) One school of thought, having its roots in the utilitarianism of the last century, formalises the matter by saying that money has less utility to those of higher incomes and that, consequently, the more of a given tax revenue that we extract

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MR. R. F. HARRIS, F.B.A.

[Continued]

from those of higher incomes, the less the burden we shall inflict. (ii) Those who prefer to think of a tax system in terms of equity hold that it is consistent with equity to take more, and that on a progressive scale, from those who can afford more.

8. Both these principles may be held to justify imposing higher taxes on a progressive scale on those who are better endowed, by heredity or environment, for earning more money. Advocates of progressive taxation usually concede that, human nature being what it is, some differentiation should be left after deduction of tax in favour of those whose endowments enable them to make a larger contribution to national output. Failing such differentiation, people will choose the easiest or pleasantest job, regardless of its value to society. Bristly people will have resort to farming, while manual workers may settle into unskilled tasks if the application of skill and exertion earns no special reward. Thus valuable services will be lost to society. This lesson was sharply taught in Russia where after a brief attempt to apply the ideal of equality, strong differentiation was introduced. Under a system of free enterprise and comparative laissez-faire, citizens tend to be rewarded in proportion to the value of their services rendered. This involves much differentiation between incomes. We think it right to reduce this differentiation by the system of progressive taxation and believe that the incentive that remains after a considerable paring down will be sufficient to evoke the best efforts. To summarise this paragraph, progressive taxation can be justified by good arguments to the extent that it reduces the differences of net income between those whose capacities, whether as the result of heredity or environment, qualify them for occupations and tasks of varying value to society. The plan that follows implies the full acceptance of this principle.

9. The progressive system is completely stripped of these logical supports when applied to those who, while qualifying by their gifts for the same job, make different earnings owing to the differences of zeal with which they go about their work. A system of progressive taxation that penalises the more zealous has nothing whatever to commend it. Yet this is how our own system applies. We may compare two men who qualify for the same semi-skilled job, one of whom earns the standard basic rate of, say, £1 a week for the job while another, whether by qualifying for bonuses or working overtime, is able to earn, say, £1½ a week. It may be that yet another, working in a grade of identical classification, through being a casual absentee where this is possible, only earns £6 10s. 0d. a week. It is quite wrong from every point of view that these differences of earnings should attract different taxes. The higher earner may need the money more, or have a greater sense of duty. In neither case should he be penalised by being subject to a larger deduction of tax. His opportunities are no greater than those of the man who earns less, and consequently he should not be regarded as having greater capacity to pay.

10. We may consider the two arguments stated above in favour of progressive taxation. One is that a pound has less utility to the man with the higher income. It is assumed that the eighth pound has the same utility to any two men and that therefore the eleventh has less utility to the man who earns £11. But in this case it is most unlikely that the eighth pound has the same utility to the two men, since if it had, they would presumably do roughly the same amount of work. The man who works harder proves by his action that money has more utility to him. It may be that he has a larger family, or that he takes more forethought for the future, or that he has the intelligence that is required to put money to interesting and fruitful uses. Of course it may merely be due to his being a gambling addict, but if that makes him work harder, it is to the general interest that the community at large should gain by his foibles, as it will only do if not rewards are so arranged that his desire for more money can be adequately satisfied by harder work.

11. If we look at progressive taxation from the point of view of equity, then also it seems unjustified in this case. The opportunities of the two men are the same, and the equitable principle should surely suggest that the tax burden for them should also be the same. It is true that if you carry the matter on a metaphysical or psychological plane, you may argue that the harder worker has a better balanced temperament and is therefore better

endowed and should be penalised accordingly. Common-sense would not, I think, enforce this idea. We punish malfactors although at heart they may be no worse than other people. Similarly it would be conformable with the general principles on which the social equilibrium is based that those with more industry or higher sense of duty should not be penalised for that.

12. It may be held that the argument of the foregoing paragraph has been too individualistic in tone to apply to all cases. Some employers, looking at the problem from their practical experience, might argue that what matters to them was not the inducement to the individual to work harder, but the readiness of the whole body of operative to work overtime or be stimulated to more intense efforts by bonus schemes. I submit that my argument applies in this case also. If the incentive of higher marginal rates of earning can be made to affect a majority of individuals in a factory, then this will manifest itself in the greater willingness of the whole body of workers to adapt themselves to plans for more intensive work. The equitable argument would then apply as between two shops, the members of one of which agreed, say, to a more general use of overtime, while the members of the other did not. The former should not be subject to the deduction of larger amounts of tax.

13. My suggestion is, therefore, that we should apply the progressive principle where the reasoning on which it is based suggests that it is applicable, and that we should not apply it where it is not applicable. It is applicable where differences of income are due to differences in the capacity to earn income springing from heredity or environment. These capacities, anyhow within the class which we are considering, will determine the grade which an earner can achieve. It is not applicable as between various individuals who achieve the same grade whose differences of earnings are due to differences in the intensity of their application to their task, whether arising from the greater need for money, or a greater sense of duty. The two men I have instanced above do not differ solely in that one has £1½ a week and the other £1 a week. That would be the sole difference between them, to take an extreme case, where one man had inherited £1½ a week and the other £1 a week. But if we regard the case in point as similar to that, we entirely neglect the fact that the man who earns £1½ a week in the same grade, has done harder work to get it. Is this fact to be ruled altogether out of account in the equitable consideration of the matter? If a given differentiation on a progressive scale is applicable as between the man who inherits £1½ a week and the one who inherits £1 a week, then that scale is clearly not applicable in equity (the progression in our system is the same, although the workers get relief of one-fifth) to distinguishing between the man who earns £1½ a week and the man who earns £1 in identically graded jobs.

14. I am proposing my scheme for application to employees up to £1,000 a year. The employer should be required to satisfy the Inland Revenue authorities about the basic rate at which each employee is engaged. The basic rate per week should assume that he is engaged for the full standard working week recognised in the shop (or mine, etc.), but works no overtime. In the case of day rates, the matter is entirely simple. In the case of piece rates, there is always a minimum guaranteed basic rate below which a man does not fall, which is usually higher than the day rates, if any, obtaining in the same shop. Bonuses should also be included as part of the standard rates, when these are paid automatically to all employees, but should not be reckoned in when they are only paid conditionally on a certain task being achieved. The employer should establish the basic rate due to each employee with the Inland Revenue.

15. The Inland Revenue should then proceed to assess tax on each individual employee, having regard to his family status, at the current rates of tax, assuming that he earns the standard basic rate of pay and no more. Tax on this rate should then be deducted from the individual's wage, whatever he does in fact earn.

16. Take the case of a married man with one child whose basic minimum rate is £5 a week. At current rates of tax he is taxed approximately 5s. 0d. a week if he earns £5; but if by working overtime, by earning some special bonuses, or by doing his work at greater intensity than is required to bring in the basic minimum, he earns £11, he is taxed nearly £1 a week. If by absenteeism he

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reduces his earnings to about £6 10s. 6d. he is not taxed at all. I suggest that he should be taxed at 5s. 6d. a week whatever is due to him owing to working above or below the prescribed normal standard. This would not, of course, apply in the case of absence due to illness.

17. Thus an employee would be subject to a definite fixed and unchanging amount of taxation per week, however hard he worked. Any extra earnings due to hard work would come to him tax free. This is how it ought to be. These extra earnings represent the value of what he does for the community and he should not be discouraged from doing that by having any part of the extra earnings subtracted from them in taxation. He would continue subject to this same amount of tax which would only be changed if one of four things happened, viz.: (i) promotion to a higher grade of job, (ii) a change in his family status, (iii) a change in the basic rate of pay given by his employer, or (iv) a change in the rates of national taxation.

18. It has to be admitted that, so far as revenue from these employees is concerned, the Inland Revenue might stand to lose on balance. They would gain something in cases where absenteeism is rife, but they would lose substantially on the higher earnings for overtime, etc. This loss to the Inland Revenue would certainly be outweighed by the gain to the national income if the system induced a considerable number of people to work harder. In these days, revenue is relied in part, not simply to finance government expenditure, but (by budget surplus) to make a balance in the whole national economy. It might well happen that this balance could be improved and the danger of inflation reduced, even if the scheme led to some smaller yield to the tax authorities, provided that it caused a considerable increase of output. Looking a little more broadly, it seems doubtful if the Inland Revenue would lose at all. Harder work would increase the national income by much more than the sums paid out in additional wages, since this harder work would make the plant more productive. Owing to the co-operation of factors, the national income is increased when one factor works harder, by more than the extra amount paid to this factor. Thus the total of taxable revenue would be raised.

19. If, none-the-less, the Revenue authorities were unduly apprehensive about possible losses, the rates of tax at the lowest levels could be moderately adjusted. At present, the jumps in the scale of tax have been deliberately placed at such points in the scale of income as to affect as few earners as possible; but as rates of pay increase, the points on the scale at which the jumps occur get pulled back into the range in which a majority of workers is subject to them. To avoid this incidence, the Chancellor may be induced (and has been) to push back the points at which the higher rates are applicable, to the loss, of course, of the Exchequer. Under my scheme it would no longer be so important to push back these points of higher incidence. If what a man has to pay is fixed in advance by reference to his grade in the factory,

then he will no longer be in danger of being himself into the range of income where the tax is at a higher scale by working harder in his grade. Therefore the point on the scale at which the higher rate begins will not affect his incentive at all. For this reason it would be possible, without adding to the burdens of wage earners as a whole, to bring forward the points at which the higher rates became payable. Alternatively, if it were thought that this would be unpopular, the Inland Revenue might rest content with the prospect that they would not be compelled in future under the pressure of incentive arguments, to push back the points of higher incidence any further.

20. It has to be admitted that the task of "establishing" the basic rates of pay applicable to each employee would impose a considerable administrative burden. The Revenue authorities would have to take full cognisance of the methods of payment used in any establishment to make sure that payments that were in fact part of the standard rate did not masquerade as special bonuses. It would have to enter into these problems rather deeply. None-the-less, on the whole, there would be a great administrative simplification and assessment. All the complications of P.A.Y.E., code numbers, etc., would go by the board. Firms also would save on the manpower at present engaged in computing tax liabilities. Once the proper tax for each individual was established, all would go forward smoothly, the same amount of tax being deducted week by week, without any further reassessment. A change in this amount would only occur if one of the four events specified in paragraph 17 above occurred.

21. It might be argued that this proposal is not of great importance on the ground that at present tax scales, the incidence of the Income Tax on manual workers is small. If the total incidence is small, a change, it may be argued, could have but small effect. Against this it must be pointed out that the marginal incidence on skilled men, and often on semi-skilled men, is not small. And it is precisely in the case of these that extra effort is of high value to the economy; anything that sharpens incentive in this sphere is especially important. Furthermore, we have to face the possibility of further wage increases which, unless the points of incidence of higher rates of tax are again pushed back, will bring as ever growing number within the range of higher marginal rates.

22. I believe that this scheme might have a notable effect in increasing output. But I will again call attention to the fact that it is justified on the grounds of justice. The present system by which the man who works harder, whether from greater need of money or greater sense of duty, is penalised, is a monstrous violation of justice. The fact that it has been allowed to continue without being strongly questioned seems to be evidence that the social conscience in regard to questions of justice has been somewhat blurred. This is an evil. It betokens loose thinking and fecklessness about matters that should be regarded as of the first importance. Anything that sharpens the public consciousness and draws attention back to questions of justice, must have a good effect on public morals.

S.F.S.I.

SUPPLEMENTARY MEMORANDUM SUBMITTED BY MR. R. F. HARROD, F.B.A.

ECONOMIC QUESTIONS

[The questions to which this Memorandum refers are printed at pages 303 and 304 of these Minutes of Evidence]

Question 1

1. I consider it highly desirable and expedient to use taxation of incomes and profits as instruments of monetary policy by the creation of disinflationary surpluses or reflationary budget deficits. I should hope that this principle was now generally approved by all political parties. It is a comparatively novel principle which may be justified on two grounds. First, the greatly enlarged size of the public revenue, now running in Britain at over a third of total National Income, makes it incumbent on those who collect it to take note of the large repercussions which the withdrawal of sums of this size will inevitably have on the whole economy. Secondly, modern economic analysis indicates more definitely than older theories that variations in

the status of the budget, viz. towards surplus or deficit, can be made to have a stabilising effect on the whole economy. I conceive that the large budget surpluses achieved by British Chancellors in the last four years have made a notable contribution to the fight against inflation; deficits of comparable size might be expected to make similar contributions in a fight against unemployment, should that become necessary.

2. This doctrine now has wide international recognition, although it has not been widely put into practice. The British constitution and the British fiscal system are both factors, not present elsewhere, which make it easier to implement this policy in Britain. Britain can make a definite contribution on the international plane by continuing to subscribe to the principle and to set an example.

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3. I hold that the general policy of surplus or deficit should be supplemented by the specific measures (deferment of depreciation allowances, etc.) referred to in question 1 (b).

4. The project of discriminating between different industries raises more complicated questions. It might be held that while the central authorities are in a good position to judge whether the general economic situation calls for disinflationary or inflationary pressure, the application of differential measures to the various industries would require far more detailed knowledge and judgment. The Government would be much more fallible in these matters of detail. Pleas of equity would also be raised, no doubt very strongly by the members of an industry which was being discriminated against.

5. Despite these arguments, I am in favour of the use of such discrimination, provided that it is applied with moderation and only in clear cases. I think that the argument on the score of equity may be met in full, for the fact of the matter is that indirect taxation, as we have it and are likely to have it in the foreseeable future, is essentially discriminatory; changes in it are also discriminatory. A non-discriminatory system of indirect taxation would have to consist, for instance, of a purchase tax of x per cent. on all goods and services whatever. We are far removed from such a system. Systems known to the modern world apply different rates of tax, or no tax, to the various articles. The pattern of taxation, discriminatory as it is, has been due to political expediency, the alleged popularity or unpopularity of certain types of tax, and some of the reasons for the existing system lie in a comparatively remote past. Since we have discrimination in any case, would it not be proper also to bring into the picture reasons of economic welfare? Political pressures will no doubt continue to play a part, but this is not a reason against allowing in principle good economic argument to play as much part as is politically feasible. If this is correct, it points to the need for reconsidering the modes of collecting certain taxes.

6. I give one hypothetical illustration drawn from the current condition of the textile industry—the argument may apply with equal force to certain other consumer goods industries. I call the illustration hypothetical because I do not wish to be deemed to be presenting the following diagnosis categorically. The departments of government alone have sufficient knowledge to judge whether the diagnosis is correct; but the illustration it provides is equally good, whether the actual facts of the moment conform to the diagnosis or not.

7. There is now serious unemployment in the textile industries. The unemployment figure for April, 1952, stood at 153 thousand compared with 10 thousand in July, 1949, and an average of 13 thousand for 1950 and the first half of 1951. Now no differentiation in favour of the textile industry is called for if it is the case that these 153 thousand men and women can and ought to be absorbed in the reasonably near future in armament manufacture (or in metal industries working for export markets). But it may be that these industries, although in principle capable of absorbing fairly large numbers of additional manpower, are not now ready to absorb such numbers from the textile industries owing to the shortage of metals and skilled labour, and, in certain cases, to delays in the completion of designs and in tooling up. It may be that these industries could absorb some extra labour, but not nearly as great a number as those unemployed. These may also be difficulties of housing and transportation which make it not feasible to get a transfer of anything like this number in the next six or twelve months. It may also be the case that as the re-armament programme gets under way and housing facilities are provided in the neighbourhood of factories, the power of absorbing labour from other industries may be much greater in six or twelve months' time than it is to-day. Then it would seem clearly undesirable to allow such very serious unemployment to persist for so long a period; it is hardly consistent with a "full employment" policy. If, but only if, this broad diagnosis is correct, it would seem expedient to extend the relief from taxation recently granted to textiles, while accompanying this extension with a perfectly reasonable warning that if the demand for manpower for re-armament grows during the next year as expected, it may be necessary

to reimpose the restrictive taxes in six or twelve months' time in order to release manpower for the armament factories. Doubt has been raised as to whether a reduction of purchase taxes at the present time would have any appreciable effect in stimulating the demand for clothing. That doubt may be justified. But it can hardly be doubted that a reduction of taxation combined with notice that it would probably be necessary to reimpose the taxes in six or twelve months' time would have a very strong effect in stimulating the purchase of clothing in the near future. Thus it might be possible to re-absorb the unemployed temporarily, as is most desirable.

8. I am not an expert on the purchase tax, but I am informed that any such plan is quite out of the question owing to the mode in which the tax is collected. The recent concessions have themselves given rise to most complicated problems and questions of equity. I am told that, in order to secure equity, one would have to have a detailed history of purchases and disposals during some time past which it would be quite beyond the power of the administration to obtain. The inquiries have to be put up with. But any idea of making further concessions and then reversing them is deemed to be altogether out of the question.

9. This clearly points to the need for revising the method by which this tax is collected. The difficulties do not appear to arise, or not in so acute a form, in the case of tobacco. Could not some system of bonding be devised for textile materials?

10. This illustration has wider application. In deciding upon modes of assessment, the main attention in the past has been focussed upon administrative convenience and enforceability. It seems that if we are to regard taxes as flexible instruments of economic policy, this aspect should be heavily weighed in deciding upon the mode of collection of any new tax, and that existing taxes should be reviewed from this point of view. This appears to me to be a matter of major importance.

Question 2 (a)

11. I am not in general in favour of assessing tax on the basis of personal expenditure rather than income. Some economists have argued that the Income Tax, as we have it, involves the double taxation of saving. I am not of this opinion and agree in this with the late Lord Stamp whose argument that there was no such double taxation appears to me irrefutable.

12. It might be held, however, that, although there is no equitable case for the change proposed, it may be expedient to give a positive encouragement to saving. It would certainly be expedient to do so at the present time; but it must be remembered that there are other times at which it is desirable to encourage spending rather than saving. (It may well be that we are fast approaching this opposite phase.)

13. To replace the existing system by an expenditure tax, which would involve a great upheaval, would be to base a permanent part of our tax structure on a principle of expediency which only has validity in certain phases and would be positively harmful in other phases.

14. The question might be raised whether one should not devise some system by which the tax would be alternately on income and on expenditure, in accordance with the principles of flexibility discussed under question 1. While it is desirable to introduce flexibility at as many points as possible, this does not seem at all an advantageous method of introducing it. I should have thought that the administrative difficulties of exempting saving from Income Tax and Surplus were insuperable. This point was always made by experts in public finance at a time when tax rates were much lower than they are now, and the motives for avoidance or evasion smaller. An exemption of saving would surely give a vast field in which to devise new methods of avoidance and evasion. At a time when so large a fraction of the brain-power of the nation is engaged upon devising subtle means of avoidance (it will not say evasion) of direct taxation, it would be the height of folly—I can put it no less strongly—to open a wide new area for the use of such devices.

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[Continued]

Question 2 (b)

15. It may be argued that capital gains should "logically" be subject to direct taxes on income. I hold that there are two powerful arguments of expediency against such a proposal and that the so-called "logical" argument has no great cogency.

16. Capital gains (and losses) may be divided into two main categories, which must be considered separately. There are those which occur when there are general upward or downward movements in the prices of assets in the different phases of the trade cycle. Secondly, there are those capital gains which arise out of the specific fortunes of particular concerns.

17. (i) From the "logical" point of view there is not much to be said for subjecting what may be called the trade cycle gains to taxation, since these tend to be balanced by equal and opposite losses in the other phase. But there is a strong argument of expediency against doing so, namely, that it would blunt the weapons of monetary management by which the authorities may hope to iron out the trade cycle. An illustration can readily be given from the recent phase. A strong disinflationary policy has led to large and wide losses on capital account. If these losses were brought into the Income Tax reckoning, the Chancellor's budgetary revenue would be subject to a very large reduction. But this would have the opposite effect from that intended by the disinflationary policy of the monetary authorities. A fall-away in budgetary revenues tends, by reducing the purchasing power that is mopped up in a budget surplus, to have an inflationary effect. Thus the disinflationary effect of a tight money policy might be largely countered by the inflationary effect of the reduction in taxes due to be paid to the Chancellor. The same argument would apply in the opposite case. We may suppose that in consequence of a trade recession, the central authorities were doing their best to re-stimulate employment by as easy money policy; under its influence stock market prices would tend to rise and capital gains be widespread. It is precisely the object of the monetary policy to bring about such gains, since it is precisely these gains that tend to stimulate new expenditure on capital account, which it is the object of the monetary policy to stimulate. But if these gains led to more onerous tax bills, this would have a deflationary effect, which might largely or entirely frustrate the intention of the monetary authority to provoke increased activity and employment, both on capital and consumer accounts. This seems to me a decisive reason against bringing these alternate gains or losses into the tax assessment.

18. (ii) The Commission will be well aware of the unfortunate effect of progressive taxation on the willingness to bear risk. Let a man have a capital from which he can earn £2K a year in safe investments. There may be a risky project in which the uncertainties are such that it will only be undertaken if the prospective modal yield is £2K per annum, viz., double the yield on the safe investment, both being considered tax-free or after deduction of a proportional tax. If there is progressive taxation the net expected modal yield of the risky investment after tax will be less than double the yield of the safe investment after tax. Consequently this particular investment will not be undertaken.

19. It is to be noted that this is an incidental and not a deliberate effect of progressive taxation. Progressive taxation has been designed to conform to the idea of ability to pay, or to give effect to equitable considerations, or to minimise the "dis-affinity" of taxation as a whole.

20. The justification for progressive taxation by these principles is probably deemed now to be fairly secure. It is not part of the intention of progressive taxation to discriminate against venture capital, but in fact it does so inevitably. We are hardly likely to rescind the system of progressive taxation for any reason whatever, and we consequently have to accept its bad effect on venture capital as an unfortunate but necessary fact in our economy.

21. But if this unfortunate effect could be somewhat mitigated, that would be all to the good. The specific capital gains due to the particular success of the firms in question (as distinct from those capital gains due to the

alternating phases of the trade cycle), are almost exclusively due to the prior undertaking of risk. Consequently the fact that the risk bearer knows that capital gains will be tax exempt may go some way to offset the deterrent effects of progressive taxation. If such capital gains were themselves subject to progressive taxation, this would reinforce the restrictive effect of our tax system on venture capital. Thus I regard the exemption of capital gains from Income Tax as a reasonable, and indeed an equitable, offset against the unintended but inevitable effect of progressive taxation in general of discouraging venture capital.

22. It should further be noticed that capital gains which are the result of the ploughing back of profits are already subject to taxation, since the profits are taxed, and any system of taxing capital gains should exempt this particular class of capital gain. This would give rise to further administrative difficulties.

Question 2 (c)

23. The introduction of a tax on the basis of personal capital would be a major administrative effort and I am not convinced that it could achieve any purpose that could not equally well be achieved by Income Tax together with the accustomed or modified differentiations between earned and unearned income, and therefore oppose this proposal.

Question 3

24. I certainly think that a fundamental change is desirable in the taxation of small incomes. I have submitted a separate memorandum on this topic.

Question 4

25. I consider that the present system of granting allowances for family circumstances is economically justifiable, but I do not think that it is sufficient. Our ideal should be to make the economic welfare of persons engaged in the same walk of life and rendering services to the community of the same value independent of the size of their families. A man should not be penalised for having a large family; he should be able to enjoy all the amenities that a man rendering identical service with a smaller family, or no family, enjoys. We shall have to move far before this ideal can be achieved.

26. In my opinion it cannot be achieved by any adjustment of the tax system, although all adjustments of the tax system tending in that direction are welcome. My reason for saying this is that in the case of men of middling incomes it would be necessary, in order to get the desired equality, not only that the men with large families should pay no Income Tax, but that they should receive positive bonuses of substantial amount from the State. While the State is prepared to legislate for minimum allowances to all, such as may prevent positive "want", it is unlikely to be willing to make allowances to those of middling incomes in order to equalise their positions with those of men with the same incomes but smaller families.

27. I believe that this problem can only be solved by a system of compulsory insurance for children, and I presented a detailed scheme for this purpose to the Royal Commission on Population (vide Vol. V of appendices).

Question 5

28. I would first point out that the proposal here, namely, to increase the differentiation between earned and unearned incomes, is diametrically opposed to the proposal in 2 (a), namely to reduce taxation on saving. "Unearned" income, as it is called, is the income derived from saving. If it is desired to encourage saving, the natural corollary would be to reduce the differentiation between earned and unearned incomes.

29. This issue may be confused for the man in the street, because he tends to think of unearned income as something due to a parceling out of British soil by William the Conqueror among his tenants in chief. Actually it may safely be said that the greater part of unearned income is due to savings that have been made in the present century, and a substantial part within the lifetime of those now receiving them.

30. It will hardly be denied that saving is discouraged by the fact that people can see what happens to those who have saved in the past.

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[Continued]

31. While my personal circumstances incline me to seek reasons for a further differentiation in favour of earned incomes, I cannot readily think of any valid ones.

Question 6

32. It appears to me that the present system of taxing company profits as such, whether or not they are shortly to enter into the stream of individual incomes, is justified on grounds of principle. In so far as profit is ploughed back, the individual should, and in the long run will, receive a capital gain. This will already have been taxed, vide 2 (b) above.

Question 7

33. I regard the Profits Tax as inequitable and inexpedient; inequitable because it differentiates against a particular form of income—and a form of income which is often especially meritorious—and inexpedient because it discriminates against a form of income which is especially likely to be saved.

34. There is an even more important reason connected with the working of private enterprise. If it is assumed that, whatever party may happen to be in power, a substantial sector of the economy will be left for private enterprise, it is important that this system should function efficiently. In the past its life-spring has been the prospect of the individual that, if he is persistently hard-working, efficient and favoured by fortune, he can build himself up from a small into a great position. Otherwise the individual will not subject himself to the extra hard work and the extra risks that are involved in private enterprise. Such a build-up implies the doubling of the initial capital several times over. British commerce and industry have been mainly created by self-finance. This has depended upon the working of compound interest. If a moderate rate of profit is ploughed back each year a doubling of the capital is possible in a comparatively small number of years, and the individual may see the prospect of establishing a great business within his own life-span.

35. It is to be feared that the present high rates of tax on business profit, of which the Profits Tax is an important ingredient—but Income Tax is also too high—will make it arithmetically impossible for the principle of compound interest to work. The new-comer cannot usually overcome this obstacle by charging customers with a higher rate of profit, because he will often be in competition with well-established concerns, for which self-finance is no longer a necessity since they can comfortably raise what capital they require in the market. The idea that outside institutions might help the small new-comer is no solution to the problem, since it is essential to his prospect that he should be able to build up at compound interest while retaining control himself.

36. I am convinced that private enterprise will not survive in a vigorous form for a long period under the existing rates of Profits and Income Tax.

37. I should have supposed that it would be difficult to exempt preference dividends without inequity, since the proportion of a business financed by preference shares may be the result of sundry past circumstances which are no longer relevant. Furthermore it is not right for a new venture to finance itself largely by preference shares; if the business is not to get into serious difficulties in awkward periods, it will need to have a large proportion of its capital on a strictly equity basis. The exemption of preference dividends would therefore seem to favour the more firmly established concerns, which is the opposite effect to that required to make private enterprise lively and progressive.

Question 8

38. I am strongly against the State adopting as the ingredient of a permanent policy measures which are designed to mitigate the evil effects of inflation. Rather it should operate on the principle that there is not to be inflation. In the whole field of economic policy, the question of inflation is the one in which the State has the clearest responsibility. The provision of a sound coinage dates from the earliest times, and the State is deeply involved in the duty of seeing that the standard

of value, which it recognises in the courts as the legal medium for the discharge of debts, is not progressively depreciated. It should be the cardinal principle of the State that there is to be no inflation. If there is inflation—except under the drastic pressures of war—that should be taken by all to be a sign that the State has not discharged its elementary duty. There should be no relaxation for permanent measures which serve to reduce the evil effects of inflation, since these would tend to make the State less mindful of its primary duty of preventing the occurrence of inflation altogether. On grounds of principle, therefore, I am entirely against introducing any permanent modification of the tax system which implies that inflation may occur and that tax liabilities should be adjusted accordingly.

39. In regard to the question addressed to me, however, I should allow two modifications to this general maxim, one of a permanent character and the other designed to meet the circumstances of today. First, I should favour an adjustment in the method of computing trading profits in relation to the changing value of trading stock (not fixed assets). Secondly, I should favour a one-off modification here and now in the valuation of fixed assets, to allow for the particular inflation which has recently occurred mainly in consequence of the war, and which is not likely to be reversed.

40. (i) It is possible that even if a stable money were achieved, which would satisfy the criterion of "avoiding inflation", there might yet be fluctuations in the general price level of raw materials. These are more liable to fluctuation than fixed assets, and it is not clear that under an ideal monetary system, some fluctuation in their general price level would not continue to occur. But even if that was disallowed, and it was held that the general price level of raw materials should not fluctuate, we might nevertheless expect substantial fluctuations in the prices of particular raw materials, and every firm deals in particular raw materials. I should therefore favour the establishment of equalisation reserves by which increases in stock valuations, due to the rises in the prices per unit of stock, would be paid, and out of which sums corresponding to decreases in valuations would be drawn. Various plans to this effect have recently been elaborated, and I have no doubt that the Commission has had submissions. I will not therefore enter into details on this matter.

41. (ii) The recent inflation is an undeniable fact and is causing hardship to many concerns. The second world war is the kind of event which justifies recognition by a special *ad hoc* measure. Many firms, unable to replace fixed assets out of the depreciation allowances recognised by the Inland Revenue, are having to go to the capital market to make fresh issues merely to sustain the physical level of their fixed assets. Thus expenditures which ought to come out of depreciation allowances are mopping up the all too scanty new savings of the economy.

42. This undoubtedly presents a very difficult problem. To get perfect equity, one would have to trace back the history of various assets and of sundry replacements that have been made; it would probably be impossible to reach a correct result, and even to get a rough approximation would be a very heavy administrative undertaking.

43. I have a constructive suggestion to make, which I believe might do rough partial justice. It would not cover the whole ground, but it would go some way to mitigate the severe incidence of the recent inflation. While the general inflation has been due to the severe pressures of war and post-war, and the State has made strong though insufficient efforts to check it, there have been two specific contributions to inflation for which the State has especial responsibility since it brought them about by deliberate act. I refer to the devaluations of the pound sterling on September 5th, 1939 and September 15th, 1949. I suggest that all fixed assets on the books of firms prior to September 18th, 1949 should have their initial costs marked up by 40 per cent. in calculating depreciation allowances due, and that all assets existing prior to September 5th, 1939 should be marked up by a further 20 per cent. This would be a clear cut adjustment which it should not be difficult to carry out.

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[continued]

44. The Commission will have had presented to it statements regarding the evil effects of the inadequate depreciation allowances. I will only single out two points for mention.

(i) Small firms may be particularly handicapped by the fact that they are unable to go to the capital market for the new capital needed to replace existing assets; and even if they could go to the capital market, doing so might involve loss of control and be therefore deleterious to private enterprise. This is a factor militating against up-rising firms on whom our progress depends.

(ii) It is open to a firm to establish its own depreciation allowances, based on replacement cost, even if the Inland Revenue will not grant such allowances for taxation purposes. But a firm has to be very strong to be able to do this, since extra monies to be set aside to provide the extra depreciation allowances based on replacement costs will all have been subject to heavy taxation. In this way, too, the existing system bears particularly severely on small up-rising firms. It has the further consequence of encouraging firms to charge prices which are below true costs of production, and this may be deleterious to Britain's balance of trade, since it may mean that we are not getting proper prices for our exports. While exporting firms often have to trim prices in order to hold their markets against foreign competition, there is a wide range of cases in which firms could secure higher prices, if their cost accounting arrangements indicated that these higher prices reflected their own costs. It is to be feared that in too many cases firms are charging prices below this owing to the method of calculating depreciation allowances, and Britain suffers accordingly.

45. In regard to the final query in section 8 I fear that in the abnormal circumstances created by the second war I should not be in favour of increasing the interest paid to debenture holders, although in strict equity they are entitled to such increase. War brings many inequities, and I fear that we must acquiesce in the further class suffering some permanent loss. I am not quite clear how this proposal to increase the monies payable to debenture holders ties up with the broad issues raised in question 8.

Question 9.

46. I have only one observation to make here, which springs from personal experience. It appears to me that earners under Schedule E are too sternly treated. I may take for example the academic profession. The allowances for books, travel and other such expenses are at present very narrowly circumscribed. For instance, the Inland Revenue authorities require to be assured that a professor (or lecturer) will actually handle the books on which a claim is made in the process of teaching or lecturing. Nothing is allowed for books required to enable the professor to prepare his lectures or enlarge his knowledge of his subject. I take the argument to be that if the professor did not incur such expenses he would nonetheless not be sacked from his position. On the other hand as an independent writer, taxed under Schedule D, is more generously treated in regard to the reading and travel necessary for equipping him for his task.

47. It seems to me that the argument in regard to office holders is too narrowly conceived. A university lecturer may incur travel and other expenses to attend the meetings of learned or scientific societies. It may be true that, if he did not attend such meetings, he would not be summarily dismissed, and therefore it is argued that such expenditure is not absolutely necessary to him for the earning of his income. On the other hand such a lecturer may, by enlarging his knowledge and acquiring reputation by the contribution to debate in such learned bodies, qualify himself for subsequent promotion to a professorship. It would be in vain if such a man, having attained

a chair, then put in a retrospective claim for all these past expenditures on the ground that he would never have obtained the chair had he not attended the meetings, etc. I would submit that a considerable liberalisation is needed in recognition of expenses for academic persons, and this may apply to others who are assessed under Schedule E.

Question 10.

48. I am not in favour of levying a special tax on excess profits under present conditions. I hold that such a special tax should only apply in clearly exceptional circumstances such as that of war.

49. The present tax was originally proposed in circumstances which gave rise to a faulty prognosis. It was generally assumed as late as last autumn that the re-armament programme would give rise to strong inflationary pressure. It now appears that this forecast was based on some miscalculation of the quantitative importance in the whole national economy of the re-armament effort. There is a further point in this connection; a moderate re-armament effort might give rise to a sizeable degree of inflation if it superimposed upon an economy fully or over extended. Since last autumn forces have been at work causing a mild depression in the general field, and in these circumstances it is most unlikely that re-armament will have any strong effect leading to an inflation of profits. It is to be observed that similar miscalculations were rife in the United States at the same time; there, too, despite the fact that the armaments programme is proportionately very much larger than ours, it does not so far appear to have had a marked inflationary effect.

50. There is, however, now proceeding in Britain some inflation which has quite other causes. As things are turning out the excess profits levy will in effect have its main incidence on the higher rates of profits accruing since 1949 which represent an adjustment of values to the devaluation which occurred in that year. It might in the abstract be argued that any extra profits accruing from the devaluation were just as eligible a target for an excess profits levy as profits accruing from re-armament. In certain circumstances this might be so, but not in the present circumstances. Wages have already been adjusted upwards to the extent of about half the devaluation, and there is every prospect, in view of the wage demands now under consideration or about to be presented, that the level of wages will rise by nearly the full extent of the devaluation. Material costs have already risen in proportion. In these circumstances it would be most unjust that profit takers should be the only class not allowed to keep step with the general re-adjustment of values caused by the devaluation. To subject the profit earners alone to a special levy in respect of devaluation profits would be most unjust. It would also be most inexpedient since it would add to those pressures, bearing with especial severity on the up-rising firms, which are caused by high Income Tax and Profits Tax, as already explained.

51. The foregoing answer is given without regard to the question of political morality involved, namely, whether an election undertaking, which may have conceivably induced certain persons to vote for a certain party, is binding when the circumstances which gave rise to the undertaking have changed. Upon this I make no comment save that it would be helpful if an impartial body, such as a Royal Commission, could issue an interim report to the effect that the reasons for which this levy was proposed, although accepted by experts at the time, were now invalidated, and that a tax of this character might do grievous injury to the economy. The public would take such a pronouncement as impartial and this might serve to solve the political conundrum of whether it was morally binding upon a government to give effect to a proposal made in different circumstances for reasons no longer valid.

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[Continued]

EXAMINATION OF WITNESS

2930. *Chairman:* We are glad to see you here. We are all grateful to you for the paper that you put in on your plan for altering the incidence of progressive taxation in regard to lower incomes and I know all members of the Commission have read it carefully, but we have a few questions to clear up with you. In paragraph 5 you refer to something which, as a Commission, we have had some difficulty in pursuing and really getting to grips with. You say:—

"Economists in Oxford who have been studying these matters have had the benefit of much evidence of this kind."

That is the discouragement to effort of existing high marginal rates of wages. What has come in, to the people you refer to, by way of actual experience on this point because we find it hard to get at it?—Your Secretary wrote and asked me if I could furnish definite statistics but our evidence was not in a form which lent itself to that; but we do make a practice of having in the course of the year a dozen or so business men to talk to us in very informal conditions and we were particularly questioning them about efficiency in the three or four years after the war (we have rather switched our topic now) and during that period we always asked them about this and the majority, these were all actually managing directors or managers, they were holding responsible positions in business, some small and some great, said they thought difficulties did arise.

2931. They were distinguishing, were they, between the marginal rate and the general effect of the incidence of high taxation?—Certainly. We made that quite clear to them, yes.

2932. It is a thing which one finds people refer to a great deal without always being able to quote actual experience?—I will admit I think there has been some adjustment of mind in the course of years and the deterrent effect of the high marginal rate is probably somewhat less now than it was in the early days.

2933. That is recognised in taxation, that people settle down?—Settle down, I think there is something in that.

2934. The scheme you put forward, as you say, is confined primarily to the wage earner and the lower salary earner, but you hold out a hope in your next paragraph that something on the same lines could be applied to the higher income tax payer?—I am afraid that is only a hope, an idea. I would not venture to make any concrete suggestion for the higher brackets. It is very much more complicated. I feel in the lower brackets you can bring it in almost straight away.

2935. It did not convey to my mind a clear idea how, when dealing with a higher income earner, you could apply anything like the scheme you have suggested of the normal working week for the lower wage earner?—It might take the form of delaying the incidence; that is to say, you might on the basis of five years' experience establish a man as being in a certain category and for a period tax him in that category regardless of his earnings. His category would have to be revised from time to time.

2936. It would mean an enormously elaborate form of organisation?—At that end, it would. I do not agree with the memorandum* which has been presented to me about the wages, though.

2937. Do you distinguish between the disincentive effect of the progressive system in its relation to the higher income earner and in its relation to the wage earner or the lower income earner?—In the broad principle the effect must be the same, but in detail there will be differences. Of course an important difference depends on the distinction between someone who is doing as well or better in life than he has been used to and the opposite case, the man who is losing, who is having to adjust himself downwards. The marginal rate is going to be more of a disincentive in the former than in the latter case.

2938. The marginal rate is more a disincentive to the man who has recently increased his position?—Yes.

2939. Because he is not committed to maintaining that extra piece of income?—Yes.

2940. But you find that circumstances affecting the higher income earner and the lower income earner... There is a distinction between the middling and the very high. I think some middling people are struggling very hard to do more in order to maintain their standard of living but in the case of the very high income earner the gain from any optional earning is so minute that it is completely discouraging.

2941. If I follow your argument in the early part of your paper, you are particularly concentrating, in regard to the wage earner, on the effect of the progressive rate on the zealous worker?—Yes, and I would add there, as a result of thinking over my paper, I think there will be a distinction as stated in it between zealous and less zealous individuals in a shop, but also an even more important distinction between one shop as a whole, and another; the employer may think it feasible to work overtime—I think overtime is the simplest example; my principle also applies to bonuses, piece work and so on—and the atmosphere in the shop may be such that he can, or alternatively he may desire to work overtime and find that the labour resistance in the shop as a whole would be too great, that is to say, there is a sort of majesty view prevailing; the men are markedly unwilling to do the overtime and the employer thinks it is not worth the struggle and effort, so there is a certain amount of collective inequality as between the two groups of people.

2942. If you are specially concerned to protect the zealous worker from the operation of the progressive system a simple proportionate tax on all that he earns would achieve the same result if you could work it out?—It would go part of the way.

2943. It would have the same attractions as your different method of approaching the problem?—It would only go part of the way.

2944. It would go part of the way?—My scheme, which amounts to a poll tax, a poll tax for each grade of worker, goes the whole way so that you get the whole benefit of your zeal. I do not know whether this would be the moment when I could say a word about the equity point in reference to the memorandum which I was allowed to read.

2945. That would be the memorandum produced by the Board of Inland Revenue?—Yes. It was suggested there would be big inequality between the people who had an opportunity of earning tax free income by overtime and those who had no opportunity. I submit that this is a great fallacy. There is no substance at all in that point. I think the most convenient way is to take three possibilities which we will call A, B and C. In the three possibilities you have the group of people who have an opportunity of working overtime and thus the opportunity and work overtime; say that their standard basic rate is £8; they take the opportunity and earn £10 a week. Secondly you have a group of people who have the same opportunity but do not take it; they show resistance to the proposal and the employer does not adopt it. They have the opportunity of making £10 a week, and they make £8. Finally you have the C group who have no opportunity and simply earn £8. It seems to me there is a basis on which you could argue that A and B have a certain opportunity, which is lacking to C, and that that is an advantage. I should suggest such differentials are common to life in general and you cannot devise a tax system with a view to ironing out such different opportunities in the lots of different people; but if there is a case for a differential there, it is clear that the people who have the extra opportunity are both A and B, they both have an extra opportunity which is denied to C. You would therefore want to tax A and B more highly if you were going into such deep equity as the people's different lots in life, but it is manifestly inequitable to say that A who has the opportunity and takes it should contribute more to national defence than B who has the same opportunity and does not take it. If there is any question of equity between those two, it is B who ought to contribute more. The people in that group have the opportunity of doing harder work and do not take the opportunity. You may say that as this is not a slave State, you should be able to buy yourself out of harder work by contributing more tax, but certainly not the other way round in those two sets of people; you should

* A Memorandum by the Board of Inland Revenue which is not reproduced in these Minutes of Evidence.

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certainly not say that those who took the opportunity to work harder should contribute more to national defence than those who did not, and to bring in the C group does not alter that as between A and B.

2946. It was the C case which I think the Board's memorandum was rather concentrating on, but your answer in effect is that that is a refinement of equity which really one cannot be expected to take account of?—It is a refinement I do not think you can take account of, but if you did take account of it you should impose higher taxes both on A and B undoubtedly.

2947. I think one of the main considerations which has been thrown up, both by the Board's memorandum you have read and other criticisms we have heard of such proposals as yours, is whether we can think of them as being practicable involving as they would, over a complex organised country like our own, negotiations on the normal week, if I can call it that, the normal week for the most varied forms of employment and also the fact that those would be fairly constantly changing and would require re-negotiation and re-approval all the time. What would you say about that?—I think there are two points there. There is the administrative burden and the actual legal point which I am not an expert on but I should like to say something about. No doubt there would be a heavy administrative burden.

2948. You recognise it?—I recognise there would be a heavy administrative burden. On the other hand there is an enormous administrative gain; once you have established your rate you do not have to worry any more, the man will continue to pay a flat rate of tax may be for months, may be for years, subject to simple adjustment if his family increases or something of that sort, but on the side of assessing each individual there is a great relief to be offset against the burden of the initial establishment of the proper rate to be paid. I would also draw attention to a point which might be neglected but which the Commission should certainly bear in mind. One must not simply think of the burden from the point of view of the Inland Revenue, but also from the point of view of the nation. We know very well many employers find P.A.Y.E. a great administrative burden. They have to have experts according to the size of their business working constantly on it. If you adopt my plan all that burden would be taken from them. We are not here concerned with the question simply of the burden of Government administration which is only one aspect. We are concerned with the absorption of national manpower in dealing with this matter. From the national and economic point of view it is just as important to release labour from firms who have to employ a lot of labour to work on the P.A.Y.E. scales as to release labour from the Inland Revenue. I think this Commission should bear this point in mind. There some difficulty was raised about the legal side of this. I am not a lawyer or an expert in industrial relations.

2949. Legal from what point?—The phrase was used how to get a legal definition of what should be paid. No doubt there would have to be an Act which defined this matter in some way, but I cannot help feeling that the difficulty is exaggerated owing to the fact that so much of the ground is already, so to speak, legally covered. To start with we have definite legal standard rates in all trades covered by wages councils. We have the Agricultural Wages Tribunal. We have the Catering Board, but in addition to that we have S.R. & O. 1951, which I gather is now amended, from 1949, by which practically the whole country is covered, that is to say, there is a rate of wages agreed through collective bargaining which is legally, or was until last year, legally binding so that there is the legal basis that already you have got under this Act legal wages for much the greater part of the wage earners. There may be some gaps in it, I do not know about that; but up to 1951, up to last year, it was illegal to pay wages below these standard rates wherever there was an agreement, a recognised agreement establishing standard rates, so that you have the law already. What is good for the goose, is good for the gander. If these agreements can be used as legally valid from the point of view of industrial disputes, they can be used from the point of view of tax collection. I am aware it was altered last year and I find it difficult to comprehend what happened last year, but none-the-less there is still under the more

recent S.R. & O. a definite wage, viz. that which has been agreed to and which is recognised and on the basis of which you can have an appeal to the Minister or the Industrial Disputes Tribunal. You have a legal foundation already.

2950. I follow that. I dare say some of my colleagues will have some questions about it but, taking things as they are, if you are going to introduce your system in some future year, you would have to contemplate re-negotiation of all these rates under current conditions, would you not?—Gradually. We have re-negotiations all the time, some are proceeding now. There would not be any special re-negotiation connected with my proposal. You would simply carry on. Most labour is either covered contractually through wages councils, etc., or through this Order by which the wage rates as agreed through collective bargaining were enforced and are still recognised; most of the ground is covered.

2951. You say they are in a form which could be satisfactorily applied for the purpose of your scheme?—Usually, not necessarily in every case, because there are many varieties, but usually. I would not myself object to the idea that the Act authorising my scheme should be applicable in all cases where this S.R. & O. is applicable and in the marginal cases where there was no agreed rate, the privilege should not obtain. That might have incidentally a very good by-product effect; it might cause agreements to be made in the marginal cases where there is now no agreement. That would be very beneficial notably in the building trade. There are often cases where work is slack because there are no good agreements of this kind and anything that would stimulate and cover the ground more completely would be all to the good and this tax concession might do it. You would not have the benefit of the tax concession unless there was an agreed rate.

2952. The three parties to any such arrangement would be the employer, the trade union and the Inland Revenue. You could not contemplate less than those parties taking part in fixing the rate?—I would not have looked at it quite like that. There are two parties usually, sometimes three parties, to wage negotiations which would be quite independent of all this tax question. All the Inland Revenue would do would be to enquire of the employer the different standard rates, the different grades in his factory. They might want an endorsement by the trade union official that these did correspond to the facts but it would merely be a question of getting your information.

2953. You could not leave it to the employer to settle for the workman with the Inland Revenue what his normal week was to be. It would have to be checked by some outside body representing the workman?—Yes. No doubt as an administrative detail to verify your reference the Inland Revenue would be able to ask the relevant trade union official whether that statement was correct, but these agreements are now all written out somewhere; they have only to be verified; they exist.

2954. I am only wondering whether they exist as widely as you are assuming if you take the whole range of the country?—I do not deny there are exceptions but I think you will find they are pretty widespread. If they are not covered by agreements, they are covered by the wage councils.

2955. The Inland Revenue would be constantly vigilant to see that rates were not agreed or reported in an attempt to evade the burden of the scheme?—That is true, that would be the administrative burden for the Inland Revenue.

2956. I really started on the practicability, as to whether you could get the thing working, rather than the administrative burden itself which I agree must be seen in terms of the whole country. You said you found employers saying that P.A.Y.E. was a very considerable administrative burden on them?—Certainly.

2957. Is that your experience as reported by the large industrial units or the small employers, or both?—I have not analysed my records from that point of view. I had the impression that it was both.

2958. As you said in another connection people settle down to these schemes and what is a very heavy and tiresome thing in the first year or two becomes a matter of routine some years later?—I only meant they settle

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down in regard to the incentive side of it, but I think on the other side they only settle down in the sense that they have their staff, they are working and they go on working, but this is still employing national manpower.

2959. As you say your scheme is a poll tax. You calculate a weekly sum, whatever it may be, which is going to be the man's obligation for tax?—It is a poll tax adjustable from time to time as a man's circumstances alter.

2960. I was not quite clear what happens on your scheme if he is away either voluntarily or for reasons that he cannot be responsible for?—Then he has an adjustment, certainly. If he is away for reasons he cannot help, for sickness or if there is short time in the factory, then of course it must be adjusted.

2961. Supposing he could only work for two days a week for a period, your poll tax is then reduced?—Yes.

2962. You have not brought that in?—I am sorry. I mentioned sickness; I ought to have mentioned it. For sickness or other causes beyond the control of the individual.

2963. If he is a voluntary absentee, he simply is not working for a period, what happens then? Does he owe the poll tax week by week?—Yes.

2964. When he comes back again has he accumulated, you spoke of 5s. as an example, he has accumulated a debt of 5s. for each week?—If he goes off for a considerable period. I was thinking of absenteeism for shorter periods normally.

2965. It may be for a long period?—There comes a time when he has lost his job. The thing is—does he go on to the debt? Once he goes on to the debt, he is out of a job.

2966. You only envisage it really as a charge on him as an active wage earner?—Yes.

2967. You sent us a recent paper in response to the questions we circulated to a number of experts of your kind. Have you got that in mind?—Yes.

2968. I have one or two questions that I wanted to ask you on that which perhaps I can take up with you. I wanted to ask you one or two things about question 2 (b), your paragraph 15, where you deal with this question of capital gains. I got the impression from reading through your treatment of that that you were really thinking of capital gains only in terms of a commercial venture. Was I right in that?—I was thinking of it mainly in that connection, yes.

2969. You do not I think make any treatment of the subject from the point of view of the man who, let us say, sells land, not a land speculator or dealer, but the man who realises what in terms is a considerable gain over the historical cost of the land, or a man who sells objects of value or the man who sells investments?—I think my coverage is roughly correct. Capital gains may be incidental to the trade cycle. We are all familiar with that capital gain. I should say all other capital gain or almost all other capital gain was absorbed in some way with carrying a risk. I do not really think there is much opportunity for a pure capital gain. You may buy some shares which you know are going to appreciate but the present price will not allow you to obtain more than whatever the current rate of interest is less tax on the appreciation. You cannot evade the incidence of income tax by buying something which is due to appreciate. Where there is an element of risk involved the matter is different.

2970. You may have monetary gains thrown up in respect of these things which are really not related to the trade cycle at all. The typical instances are the appreciation of money and the change in the rates of interest?—I would include gains due to rates of interest under my trade cycle heading. I have said something elsewhere about the undesirability of catering for inflation as a normal state of affairs. One would hope that, when we settle down, while there may be changes in these capital values up and down in relation to the trade cycle, we shall not continue to have a permanent upward trend of all values.

2971. Do you think it is a satisfactory conception of the capital gain that you regard the gain on a single asset without considering the total position of the taxpayer concerned?—I do not think I quite follow that.

2972. He may hold a variety of forms of property. He may realise one and obtain a profit on that as against what it cost him but his total position, would you take that into account?—My written answer to that question was based on a thoroughgoing tax of capital gains, that is to say, a tax that would assess the value of your property at the end of the year compared with the value of it at the beginning of the year.

2973. I had not followed your approach. You really take a balance sheet of the taxpayer's whole position at the beginning of the year and at the end of the year?—Yes.

2974. The trouble about that is it is generally felt to be impracticable?—Yes.

2975. You were not dealing with the situation in which one only fixes one's attention on the event of the year which is a realised gain or a realised loss?—From the broad point of view that is quite irrational unless you are interested in somehow thinking of the taxpayer's spending. If you think in terms of his selling an asset in order to spend it, from that point of view one can see a rationale behind it but from the general point of view one sees no particular sense in distinguishing between realised and unrealised gains.

2976. Mr. Kaldor: Just a few questions. I should like to deal with your second document. You have just said in answer to a question by the Chairman that in cases where capital appreciation is fully expected and there is no element of risk involved, the owner of such capital or securities does not really make any capital gain because the current prices of that share would be so adjusted as to make the appreciation equal to the rate of interest less the rate of income tax. That is your point?—Yes.

2977. That would not apply to surtax?—On the question of surtax payers, I think it is possible they could make a bit by that method though it rather depends. It would be too simple to say they get off the whole of the surtax; the prospect of doing that would cause the surtax payers to buy these assets; but I dare say the higher range of surtax payers would get off a bit of their tax and the lowest range may not think them worth buying. You might take it as a way of evening out the surtax scale. I do not deny the high surtax payer probably could avoid some surtax.

2978. Anyhow you would not expect the market valuation of such securities, take Government stocks as a case in point, to be so adjusted that surtax payers would not gain by such a process?—On such a security as Government stocks the surtax payers would presumably.

2979. As an economist, you would not dispute that, logically, if you take income as the basis of taxation, capital gains should be interpreted as part of income. I suppose your objections are more on grounds of expediency and not on grounds of principle?—I would not say that altogether. I suppose we are all agreed that we must subtract the capital gains due to the ploughing back of profits. Profit ploughed back is taxed and so much of the writing up of shares in the market is due to the fact that profit has been ploughed back; this profit has been subject to tax already and therefore the capital gain due to it has already been subject to tax. I will now deal with capital gains outside that. It occurred to me I did not mention the question of loss. You have to bring in loss. The mere fact that capital gain is essentially associated with a risk bearing means that one must think of the people who make capital gains in a class with those who make losses. If a loss is a small one, under the capital gains tax system it might be set off against other income. After the losses exceed other income and I do not know whether anyone has proposed that the Inland Revenue should write cheques to people who have made heavy losses, yet that would indeed be the logical consequence of the principle of taxing capital gains. If it is held that those who make capital gains should be taxed, those who make losses which exceed their total income, as they often may, should receive

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cheques from the Inland Revenue. I do not know if these cheques would be worked out on a progressive scale. If so, that would be splendid. You would get a grand bankrupt getting the Inland Revenue to pay 15s. 6d. He would be able to discharge his bankruptcy quite quickly that way; but I think we must take this absolutely seriously; the loss and gain must be reckoned together and we cannot say a tax which includes capital gains is equitable unless there is a provision for dealing with losses which I may remind members here, even in these days of inflation and easy profit, remain widespread. Every year there are many people who lose far more money than their income.

2980. At paragraph 17 you suggest a capital gains tax would have a de-stabilising effect on the trade cycle?—Yes.

2981. Your point here is that during a period of boom capital losses are made and during a period of depression capital gains are made. Is that that is what you are saying?—Yes.

2982. Have you looked at the American tax returns, their capital gains in the boom years and the depression years?—I think you have over-simplified my point. I was not simply contrasting movements up and down, but contrasting a period when the authorities are trying to make money easy with a view to revival; how quickly in future the authorities can do that when a depression occurs we do not know. In the past they have been somewhat dilatory but once the easy money policy works its way into the system you expect capital gains beginning with maybe Government securities and gradually being diffused. That is part of your easy money policy to re-stimulate investment, and conversely with a disinflationary policy. I was thinking of these capital gains or losses in relation to a definite policy of inflation or deflation where I think the effect of a tax would work against the authorities. I do not wish to deny in the early days of a slump you can get very heavy losses.

2983. You would agree in general that large movements in capital values, in which capital gains and losses are made on a large scale, arise from changes in valuation of ordinary shares?—Yes.

2984. Ordinary shares I should have thought correlate pretty well with the various phases of the trade cycle. There is not a slump in the market much before there is a slump in the country; there is not a boom in the market much before there is a boom in the country. I suppose your argument is that there is an amount of lag; capital gains are made before there is a boom?—The equities usually follow the gilt-edged securities with a lag. If you have a policy which is designed to effect a rise in gilt-edged securities the equities will come along at a somewhat later period, but I see the source of confusion is that I was considering this, not from the point of view of boom or slump as they happen, but from the point of view of a monetary policy designed to reverse the effect. If you have a slump and the monetary authorities are trying to re-stimulate the system, to the extent that they are successful they will cause a rise in capital values. That happened here in the early 30's and was said to be a definite factor making new investment possible; now the authorities have been trying to depress capital values recently quite deliberately as a disinflationary policy.

2985. You would not really disagree that on the whole in the past, at any rate up to now, these movements, these counter-cyclical movements in gilt-edged values were overshadowed, as far as net gains and losses are concerned, by the very large movement in equity values. In 1932 and 1933 capital gains were made at a much later period when the economy was progressive.—In these days the importance of gilt-edged is very great compared with equities. You have a national debt of £26,000 millions in all; with the very large size of the national debt one must consider gilt-edged as very important in the total picture whether gains or losses are being made.

2986. This was an argument on the question as to whether a capital gains tax would have a stabilising or a de-stabilising effect, a point I do not consider of real importance in either case. I do not know if you would. As compared with other factors I do not think the effect of a capital gains tax on spendings or savings would be very large. The main point for a capital gains tax is

a question of equity as between different individuals. You would not dispute the basic point that a man who habitually makes capital gains or capital appreciation is taxed less heavily in relation to his true taxable capacity than another man who makes no such capital gains?—As far as the equity is concerned, I must insist on bringing in the losses. You take the people who put their money at risk; as a class they get away with very little net. We do not know how much because no statistical computations of a satisfactory kind have ever been made on this topic, but I do not really believe the reward of bearing risks has been so very generous when losses are taken into account. No one has suggested how you can give money back to those who make losses. In that case it is inequitable to tax people who make capital gains due to having taken a risk.

2987. You are aware of the American system of the capital gains tax?—Only in outline. The capital gains tax is at a reduced rate and on realisations.

2988. Yes, but there are provisions for carrying losses forward and for setting them against income. There are all sorts of provisions to deal with losses and the tax is a tax on net gain?—Yes.

2989. I think your argument is that it would cause a kind of double taxation to tax capital gains. Is that what you say, a double tax on savings?—No, it is not the same at all. It is going to be very difficult administratively to distinguish capital gains in the sense of rising value of shares on the Stock Exchange and the firm who has ploughed back a lot of profit in previous years having established a quasi-monopolistic position or by any other method of causing capital gain to occur, but it would certainly be double taxation. First it taxes the profit ploughed back and then taxes appreciation in the price of shares due to the ploughing back. That would be double taxation with a vengeance.

2990. Would not that depend on the actual position of the individual shareholder?—I am not clear about that.

2991. The profits presumably have been taxed at some standard rate?—Yes.

2992. The owner of the property might be liable to a much higher rate of tax. It might be suggested high undistributed profits are a form of evading surtax?—Yes.

2993. In effect you would probably argue in favour of the abolition of the present profits tax as you say in answer to question 77—I think so.

2994. Would not that make this particular problem, given our present system of taxation, greater since by not distributing profits a man can evade surtax liability, or rather shareholders can evade surtax liability?—Yes, I dare say that is so. It is in fact a slight encouragement to saving. A surtax payer if he ploughs the money back cannot be spending it. I should regard it as a slight encouragement to saving, a system by which if you did plough your profits faithfully back you do get off surtax.

2995. Not if you have capital gains?—Which you subsequently realise.

2996. Whether you realise this particular gain or not, your assets are greater, you may realise something else, but anything reflected in capital values is realisable from the point of view of the shareholder irrespective of whether it is distributed or not?—Yes. These are really questions of evasion which are serious and will always be serious when tax rates are so high. I am sure any tax on capital gains would give rise to much greater evasion. You would have dealings between high surtax payers and low surtax payers where both parties can make a very substantial benefit to each other. It is a tax on capital gains and a rebate on realised losses. High and low surtax payers can sell capital assets to each other at prices which are suitable for them both to put some money in their pockets. I am sure a tax on capital gains will make these opportunities of evasion great. I do not deny there are opportunities of the kind Mr. Kaldor has suggested for evasion now. That is one of the evil effects of such high taxation.

2997. I am not talking of evasion. I am talking of equity which is a different matter.—Perhaps I should not have said evasion; I should have said avoidance. Where tax can be avoided by various means there will be a lapse from perfect equity. People should not avoid their

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be inclined in this case to leave things alone. The differential has something in its favour, it shades into the whole system of progression that we have. It is one way of helping a person of relatively small means. I feel it is a question of when in doubt preserve the *status quo*.

3019. In paragraph 32 I am not quite clear what your argument is. You come to the conclusion that the present system of taxing company profits is justified on grounds of principle.—Excuse me interrupting, I am not being asked about the profits tax but the incidence of income tax on company profits?

3020. Yes, I gather you take that view on the ground that since undistributed profits are taxed, that form of taxation is a substitute for the benefits that accrue to the shareholder in ways other than by way of an income which becomes subject to tax in his hands?—Is it not simply that this part of capital gains is a proper subject of taxation and is in fact taxed in this way?

3021. Why do you say that this particular part or form of capital gains is a fit subject for taxation?—After all, the profit accrues at the end of the year whether distributed or ploughed back and represents the value of the service rendered by the shareholders during the course of the year.

3022. Of course he cannot lay his hands on it?—Sometimes not. He might sell; he may have to wait for the income to be reflected in the share values. He may have to wait some time, but I should have thought by and large rough justice was done here. On the whole the value of the shares will reflect the value of the capital in the concern.

3023. The whole of your case rests here on your conception of a company as a group of persons and nothing more?—Yes.

3024. It does not rest upon the conception of a company as a separate corpse which is a proper subject for taxation in itself?—No; it seems to me that a company has no such existence. The receipts of the company are paid out in wage earnings, salary earnings, etc., or accrue to the owners of the company whether in the form of distributed dividends or in the form of their assets being increased in value.

3025. That, I take it, is part of your case against profits tax?—Yes. If you have a profits tax it differentiates against people who make their money in this particular way.

3026. In paragraph 38 and in successive paragraphs, taking that whole section, you suggest that the problem of replacement costs in its widest form as we have it today could best be taken care of in part by a once-for-all adjustment of assets of a certain life which are specified. You adopt that expedient while at the same time you are opposed to any continuous adjustment of depreciation allowances?—Yes.

3027. In that you differ from a number of advocates of other methods, but I wondered if you took a similar view of the proposal which has been made from time to time that there should be continuous adjustment of personal allowances to take account of changes in the purchasing power of the £?—No. There are in fact *ad hoc* adjustments in personal allowances from time to time as you have noticed in the last few years, but I should hate to have that built in to our permanent system on the grounds I have mentioned, viz., that I do not think we should recognise progressive inflation as a normal or proper state of affairs. It is perfectly proper to make *ad hoc* arrangements now to cover an inflation which is the result of this second war, a very great economic phenomenon and one likely to lead to great dislocation; therefore to make a special *ad hoc* arrangement to re-adjust values to that is reasonable, but I do not like the idea of building into your system adjustments which imply that inflation is going to be with us permanently.

3028. It would also imply that deflation might occur from time to time?—Yes. I think the primary duty of Government should be to aim at stability in values.

3029. Supposing you had in fact both forms of adjustment built into your system, would that not provide an additional spur on the Government to act with greater vigour and promptitude in countering inflation or deflation?—I do not know. I should rather doubt this

particular item among all the other sources, such as, in the case of deflation, unemployment, or, in the case of inflation, increased cost of living. I should have thought there would be strong forces which would in future make the Government more active to prevent inflation and deflation; they may not be strong enough, but I should have thought that the particular factor which you mention would not be very big in the whole picture of pressures upon the Government.

3030. What I had in mind was this. If you, as Chancellor, know that a rise in prices is going to diminish your estimate of revenue from profits taxation because of these flexible allowances, will you not be even more anxious to take steps other than fiscal steps to prevent inflation?—Yes. You recollect I did make a statement so far as the value of material is concerned and that would operate in that way I think. The effect you mention would be appreciable but I doubt if it would compare in strength with other forces that would be operating upon the Chancellor.

3031. Mr. Carrington: I would like a little clarification on your paragraph 32 in the second document, your answer to question 6. What is your view of the proposition that a company controlled in this country and operating abroad should be taxed only on the profits remitted from its overseas operations as compared with the present situation where it is taxed on the whole profits?—You are suggesting a reform by which the profits accruing abroad...

3032. Should not be taxed unless and until they were remitted to this country?—I am sorry, I am going away from strict equity now; that would make the disincense to remit them home even stronger than at present. I thought our balance of payments was suffering severely because companies were not remitting profits home to the same extent as they were before the war. This would be a clear lead to them not to remit home.

3033. You appreciate that many companies have actually changed their domicile because of this present fiscal position. Do you not think that if the law had been as I have indicated those companies would have stayed here?—They might have, I suppose. I would not like to give an answer on that particular point.

3034. Would you like to express a view on whether the advantages would be to retain such companies in this country, or the disadvantages on the balance of payments would outweigh the advantages of retaining companies here?—I should very much like to retain the companies here. If you just look at those companies, the advantage of your plan is, I think, probably clear, but what about the incentive to people to begin investing capital outside this country because the return would be tax free. Would it not provoke a flight of capital out of the country to operate in a place where the proceeds would be tax free? Though in the long run that may be a very good thing to happen, at the moment we cannot afford it and in fact have other means of trying to prevent it. You may prevent it to some extent but you cannot do so altogether, and it would be a very strong inducement for people to put new money into operations abroad which would otherwise be left here at home and at this particular juncture we cannot afford it to happen. I do not know how you avoid that.

3035. May I take you to paragraphs 38 and 39, your answer to question 8? In answer to Mr. Crick, you suggested a once-for-all adjustment of fixed assets, which is set out in paragraph 43. Then you say quite broadly you would permit some adjustment in regard to stocks and the basis of valuation of stocks. Would you mind elaborating that and telling me what you had in mind?—I am afraid I would not like to do that. I imagine you must have had witnesses before this Commission. I know certain elaborate plans have been worked out for forming a sort of stabilisation fund into which the profits from the appreciation of stock prices would be put. The broad idea is to segregate profit due to the appreciation of stock, exempt it from tax, and put it into an equalisation fund which would be drawn out in the opposite circumstances. I know people have been working on this, but I have not myself gone into any detailed scheme.

3036. You are putting the proposition forward as general lines and not advocating any one of the various methods that have been put forward?—No.

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3037. It has been suggested in some papers submitted to us that that would have an inflationary effect in that it would lead companies to increase their prices. Do you agree with that or not?—To increase the value?

3038. To increase their selling prices?—With a view to avoiding tax?

3039. No. I quote if I may from a recent recommendation of the Institute of Chartered Accountants speaking on the subject of accounting in relation to changes in the purchasing power of money. They say:—

"The following are some of the questions which would need consideration. . . . (b) The determination of prices of goods and services, particularly the question whether a new conception of profit would make it necessary for prices to be raised in order to enable a business to pay a fair return to the investors, or indeed to make a profit at all."

In other words, whether the effect would be to cause a further fall in the purchasing power of money and thereby aggravate the problem. That is referred to in other of our documents.

3040. Professor Hicks: Has not Mr. Harris dealt with this point in paragraph 44 of his paper?—Yes, I think that is so. I regard inflation normally in terms of an excessive demand in relation to the supply potential, but when it is a question of putting up prices to cover costs properly, I do not think that is necessarily a bad thing. I have just touched on that in paragraph 44. We all know "inflation" is used in so many different senses. A rise in prices cannot necessarily be said to be an evil where those prices reflect current costs, and it seems to me if it is necessary in order to pay a normal dividend to charge a certain price, you should charge that price and not pay your dividend out of the profit on the appreciation of your stock in trade. It would force you to charge a higher price which would be the true price. It may be that in many cases people are selling below the true price because they are not forced to put the profit on appreciation of stock into a separate account.

3041. Chalmers: In paragraph 44 you were directing yourself to an adequate depreciation allowance?—Yes. It may be another reason why people are charging lower prices than they should.

3042. Mr. Carrington: Your point is that over a large field of British industry prices have been too low in that they have not secured an adequate return to the manufacturer, is that it?—Yes, because they have not. Strictly speaking, the manufacturer may have had an adequate return for himself, but not have been covering costs properly because he has not had sufficient depreciation allowances, etc.

3043. Just one further point, switching to your first document. As you are no doubt aware, we have had a lot of representations concerning the desirability or otherwise of linking income tax with social security. Have you any views on that point?—I have certainly studied some of those schemes. I am all in favour of this principle. I have no special work of my own to submit on that but in broad outline it is a sound idea.

3044. Mr. Geoffrey Heyworth: On the first paper, just following Mrs. Sutherland's point a little further, I want to see how this normal tax system would work in a given set of circumstances. Let us suppose in a particular industry, or an establishment in an industry, that there is a minimum wage of £6; over and above that there are what is known as "job values" for various types of work, they vary and add so that £6 all the way up to £2 more, and, if you like to make the pattern absolutely clear, the average wage of the unskilled or semi-skilled, I am not talking of the maintenance people, in this industry is £6 10s. Under your system how do we arrive at the normal amount, on the £6, on each individual according to his job value or on the average of the whole lot?—My *prima facie* answer to that is on £6. I am not clear about the "job values." These are in the nature of additional payments which a man can earn if he works up to a certain level?

3045. No, that is the point. The job values are arrived at. . . . Are they a sort of grading of the individual?

3046. Not necessarily. These jobs are all skilled, unskilled or semi-skilled. You merely say this particular job requires more physical effort than another one, therefore you reward the physical effort by an additional payment of 10s. a week. Another job requires extra concentration or something like that, or some responsibility more than the average, and you award a job value which is fixed at, say, 15s. It does not depend on output or any other thing. I will give you one particular pattern in an industry where 15 per cent of the people get the £6, the minimum rate, and all the others some proportion all the way up to the £2, the main group being £6 10s. Where do we start?—I am afraid it looks to me as if each individual would have to be rated separately according to my principle. It is really the equivalent of a very fine grading; each individual would have to be fixed. Would these job values be varied week by week?

3047. Not week by week but periodically. We have to grade someone up for this particular job and you take a man for it. If you take each individual you have to retain that principle throughout and therefore every time a man was shifted to a new job with a new job value he would have to start again with this system, you would have to re-assess him?—I am afraid so.

3048. There is a lot of industry where this principle applies?—Yes.

3049. In that case the incentive to the man to qualify for a job carrying a higher job value is not there because we should have to start him again?—Once in this job then his pay does not vary according to how much he does? No? Then I am afraid I would have to have separate individual assessments. I do not see how one could simplify further and charge on £5 for all. That would be carrying the simplification too far, I should say.

3050. Mr. Woodcock: On your second memorandum I have just two questions on capital losses. You are not asking, or are you, that a man should receive back from the Revenue more than he had paid in tax at one time or another?—No, I am not advocating that. I am only saying if you have a capital gain tax it would logically follow if you want to be equitable.

3051. Would it? Is it not sufficient logically to set off losses against tax paid only?—If your losses can be set off against your general income, that is all right, but where a loss exceeds the income . . .

3052. Even then, at the most, you could set it off by going back or carrying it forward but certainly only up to the amount of tax you pay of one kind or another, the tax on previous capital gains or gains in a previous period or income at any period, but surely the uppermost limit would be you could only recover from tax paid?—I think that is absolutely true, but that only shows that the tax on capital gains is inequitable. It is very difficult to give figures that are strictly accurate, but a man has a bit of capital and he may make £1,000 a year by gilt-edged investment. . . .

3053. Capital appreciation?—No, on gilt-edged investment.

3054. Income?—An income of £1,000, or by taking a risk he can make an income of £2,000 a year with half a chance that he will lose his capital, we will say of £20,000, completely at any time during the next 20 years, until his business is well established. His luck does not hold good and within 20 years he has lost his £20,000 and he goes bust. That is all right; you are taxing him on £2,000 a year. I am sorry I took such a low figure, but assume you are taxing on a high rate of surtax. If in 20 years the business goes bust he goes out without his £20,000. It is precisely because that might happen, the economic system allows him to draw £2,000 if it goes well, it is a payment for having taken a risk, that other £1,000 a year. He preferred to take the risk. He says "I hope to get £2,000 a year but I recognise that at any time in the first 20 years of this business I may go bust as many people do and lose that £20,000." You tax him at a high rate of surtax on the extra £2,000 but if he loses that £20,000 you do not give him a cheque. Therefore in the event of his consolidating and making a capital gain of £20,000 you should not tax him on that; you should confine yourself to the tax on £2,000 per annum.

* Paragraph 311 of Recommendation XV of the Recommendations on Accounting Principles issued by the Institute of Chartered Accountants in England and Wales.

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3055. But he could set it against future earnings. You are not assuming he is going to atrophy at the state in which he loses his capital?—Many people do.

3056. Is it an assumption that they will do that? I am saying not only in practice but in equity it is enough to enable a man to set off tax he paid on gains against his losses. It could only be to the limit of the tax he had paid?—Not only is this tax going to be paid under the capital gains system on the £2,000 a year he is making, but there will probably be a capital gain on his £20,000 which will be worth £40,000 on the Stock Exchange, and the proposition is he will not only pay income tax on the £2,000 a year, but on the appreciation of his capital, if he does well, from £20,000 to £40,000 and that is the tax the capital gains people are asking you to levy. I say if such a tax on gains is levied and you lose the £20,000 you should get back a cheque equal to the tax on £20,000.

3057. Only to the amount of tax?—That does not seem to apply when he is gaining.

3058. You agree it should be considered part of his income?—But the point is once we conceive of capital gains as part of income, the income may be negative.

3059. You said we must conceive there may be losses made, but if you take into account losses, as I suppose we must, he would take them into account against his liability for tax. There can be no question even in equity of the State making a contribution when he has paid no tax?—It is certainly not a proposition the taxpayers would like, the people who would have to make this contribution, but in equity I do not see how you can dispute it.

3060. We all have to pay tax surely?—I agree, I fully agree; but I say capital gains of this kind should not be taxed because there is no fair offset.

3061. In paragraph 38 of your second memorandum, this is probably not relevant to the point you are arguing here, but you do come down rather completely against inflation. That may be the difference between us. You say the State should keep the value of money completely stable?—Approximately stable.

3062. And you are probably giving me the answer I was in doubt about. It never has been stable, there has been a constant depreciation in the value of money?—Not in Britain. For about 100 years prior to 1914, on the whole, the value of money appreciated.

3063. But over a longer period?—If you take a longer period, yes, because civilisation and economic prosperity probably only go in small patches.

3064. If the general tendency was not slightly in the direction of diminishing the value of your outgoings, the burden of capital would become intolerable in time?—The burden of war debt?

3065. The burden of capital, not merely the war debt. —If the assets are there it should not be a burden. It is only unproductive debt that is a burden. I do not deny it would not be a bad thing to have inflation at a sort of rate of something like 0.5 per cent. a year. In the course of a century or two the value of money would be halved, but I do not think that inflation would be sufficiently severe to require fundamental changes in taxation.

3066. That is what I was getting at.—A gentle inflation taking place over a very long period might be a good thing.

3067. Turning to your first memorandum, I gather that the basis of your scheme is really set out in paragraph 13 and perhaps in this phrase:—

"It is not applicable as between various individuals who achieve the same grade whose differences of earning are due to differences in the intensity of their application to their task."

That is the basis?—Yes.

3068. What do you mean by grade? Is grade in your sense determined by an income, a range of income? When you say people in the same grade, do you mean people within a certain income range?—I was thinking of it rather more definitely, of a person who gets a billet for which there is a definite recognised rate of pay, which rate of pay may be a flat rate of pay or a piece rate or contain a prospect of getting bonuses, etc., etc., but by

the same grade I mean two men or women who are in jobs where the prospects are identical, their opportunities are identical, but what they earn may be different.

3069. Take industry A where there is a possibility of overtime and industry B where there is no possibility of overtime; are they in the same grade for your purpose?—Yes.

3070. On that basis why not give a special relief to coalminers as compared with weaving, or perhaps it is compared with being a trade union official?—Special relief?

3071. Why not follow that same argument? If the progressive principle is not applicable, why not depart from it in the case of the miner because of the intensity of his effort during any normal period when compared with the intensity of anybody else's effort in other jobs?—I would say there, what is the standard week supposed to be? Is it that accepted by the Union? Is that the standard week? What do you earn if you work that standard week? Some are on day rates; some are on piece rates. If they are on piece rates what is the minimum rate this man on piece rates is expected to earn?

3072. I understand that, but you make a distinction between the money earned in a standard period and the money earned outside that standard period for the purpose of giving encouragement to people to work outside the standard period. If that is a good principle to apply to standard periods and outside standard periods, is it not a good principle to apply to different occupations? Why should you not say to people working in mining, which is much more arduous than many other forms of occupation, that they shall have tax relief as compared with, say, those working in weaving?—But the miner is supposed to get more pay, it is supposed to be done in that way. We have agreed on the progressive system generally. There are certain jobs where you can make more money if you can do them, if you are lucky enough to be able to do them. We have agreed to scale it down by progressive taxation.

3073. Why not make overtime more valuable to a man by increasing the overtime rate, why not send the overtime rate up ten times which is the principle now applied in a limited sense?—But that is raising your cost of production.

3074. Mr. Kaldor: So is higher wages to miners?—So is higher wages to miners, but the point is why should the cost of sustaining the Army and Navy be borne by the marginal worker? That is what I cannot see. It has to be borne by us all in proportion to our income.

3075. Mr. Woodcock: I want to find what is your marginal work on your principle. Under the progressive system we know what you mean by marginal income. You want to bring in another concept to say that between normal working hours and overtime there should be a distinction. Why merely between normal hours and overtime hours and extra effort, why not apply the same principle to jobs that are arduous, that call for special effort and special skill? In other words, I come back to my question, when you say "in the same grade" what do you mean by the same grade. Is it an income level?—It is an opportunity to earn an equal income.

3076. You say in paragraph 14, of course, workers up to £1,000 a year. How do you define that £1,000 for this purpose. Obviously your scheme has nothing to do with earnings. It has to do with some basic wage. How do you define the £1,000?—Where the salary offered is not more than £1,000.

3077. Then in the case of a head waiter offered 15s. who actually earns £30,000 a year, he is to be taxed at 5s. a week?—He is outside my scheme.

3078. Surely he is not outside your scheme. You say the wages. That would be a trade union wage. I said 15s., it might be £37—I am sorry, he is inside my scheme.

3079. Do you propose that should happen?—It is certainly an anomaly. Are we sure that he pays this high rate of surtax under the existing system?

3080. It goes right through. Take the case of a builder, he has got several different rates but we will take two. He has an hourly rate for hours actually worked and a "full back" rate which he is paid if in any week he does a certain number of hours but not the full number of hours. I suppose the standard for this purpose would

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be the hourly rate multiplied by the number of hours in the standard week?—Subject to his being offered that amount of work.

3081. The full amount of work? In the weeks when he only gets his full back rate which is equivalent to 30 hours a week, is he to be taxed on the full rate?—He is not to be taxed on more than he is offered.

3082. A man may not be able to work because of rain, but a fellow working in another place may be able to work the full time because there is no rain there or because the roof is on the building and he is working inside. They both pay 5s.3.—I have already said that where the deficiency of work done compared with the standard week is through sickness or any other cause not the man's own fault, then his tax bill must be less accordingly.

3083. What happens to the man who gets his pay for 30 hours, what would he pay in tax?—He pays whatever tax he would pay under the existing system of 30 hours work.

3084. We have to have two tax systems running together?—No. In the majority of cases people either work the standard week in their trade or if they do not do so it is through their own fault except when ill. I do not say that applies in building but it would cover the majority of my workers.

3085. Have you never heard of raw material shortages?—They may occasionally occur. Where of course the work offered to the man is less than the standard week on which you would assess the tax, then he must pay a lower rate of tax according to the work that is actually provided for him. That is quite clear but I am not of opinion that that is going to touch anything like the majority.

3086. You mentioned wage councils. Do you know what the main job of the wage council is. It is not to fix the standard wage or a standard week?—A minimum.

3087. A minimum. The standard in any industry may be something very different from that laid down by the wage council as a statutory minimum which is obligatory, so that in the wage council trades you cannot say that there is a standard week. There is no legal standard; there is a legal minimum?—We were discussing that point with Miss Southwood. Perhaps I overstressed the possibility of these wage councils coming to our help. In those cases you would have to establish with the employer what the standard wage was.

3088. The Industrial Disputes Tribunal, to give one of its powers, has the right to consider, if asked by an employer in the trade or a union in the trade, whether a particular employment is within the scope of collective agreements?—That is last year's Order.

3089. That is the amended Order. You can take it from me the old order was of very little help to what you have to say because its basis was prohibition of strikes.—That may have been its basis but it did recognise certain rates as legal rates. It may be its persistence and basis, but the upshot was that certain rates were legal.

3090. Since the Government prohibited work people from striking they had to have some machinery to deal with difficulties. That is not the case with the new Industrial Disputes Order, but will you take it from me that the only power the Industrial Disputes Tribunal has is to consider on an issue raised before them whether, on the whole of the wages and working conditions, the terms granted by one employer are at least as favourable or not less favourable than those laid down in the agreement?—That is now the position but prior to the amendment last year there was definitely a legal wage. You may say that was to prevent strikes, that may be so, but wherever there has been this agreement there was a legal wage which it was illegal not to pay and that covered by far the greater part of industry.

3091. There was a wage which could be made an obligation on employers to observe, that is to say, an employer could be required to observe something not less favourable than that, but they are not standards. If you followed that through, would not people go to the Tribunal to get established a rate of wages or a system of payment which made it easy to secure additional payments without any extra effort anyway?—In whose interest?

3092. Would it not be possible for unions and employers jointly to agree and even get the Tribunal to endorse a normal week of 24 hours?—I should not have thought so. I should not have thought it was the interest of both parties. They have their own interests anyhow quite apart from the effects of taxation.

3093. Could we deal with engineering first? If the employers and the trade unions agreed on a 24-hour week the Tribunal could only accept that as the standard working week and they could only force those hours on the employers who were members of the Engineering Federation. That is the full limit of what the Tribunal can do, so the Tribunal would not be a guarantee of a fair standard working week?—I still think you are implying there will be collusion between important unions and employers' associations to set up low standards of pay and hours with a view to avoiding tax. That is a hypothesis I personally am very doubtful about. Then there would be another Tribunal to which the Inland Revenue could appeal and say: "Is this a tax evasion dodge or not?" I do not think you will find responsible unions or employers settling low rates of wages and low hours in order to bring about this tax evasion dodge. I challenge you on that.

3094. I do not suggest that. I asked about machinery. If they agreed, not that they would, if the employers and employees agreed a 24 hour week was the normal week for engineering, the Industrial Disputes Tribunal could not upset that decision?—Of course, they would not.

3095. Therefore I come back to my original question, who is to determine a standard week?—I have not dogmatised about this. Supposing you had a reference to S.R. & O. 1376 in the original Act. There must be an appeal by the Inland Revenue from that to some independent Tribunal. If, on the other hand, you have not mentioned it at all as binding, you merely use it where useful. You say it is the duty of the Inland Revenue to establish what the standard week and standard rates of pay are. Where there are these agreements between the unions and employers and they seem to represent a fair standard, they may be used. Where in the case of wage councils there is no agreed rate which can fairly represent the standard rate operated, then the Inland Revenue must get the employers in agreement with the union officials or shop stewards, whoever it may be, to say these are the rates running in this factory. That is all they have to do, get agreement what are the rates running in this factory.

3096. Mr. Sullock: I want to follow this up a bit further because I have doubts on the practicality of your scheme. You told us earlier on you had consulted managerial and industrial chiefs?—Yes.

3097. Have you at any time ascertained the facts the manual operatives could give you?—I have discussed matters with manual operatives but not on this particular set of enquiries relating to this point of view.

3098. Do you not think you might have put up a sounder case if you got facts from those doing the job?—Our enquiry was not concerned solely with the effect of PAYE, but these points came up in the course of the enquiry.

3099. I am thinking of overtime in particular.—I am sure if we had been enquiring specifically on that point it would have been absolutely needless to get evidence from manual operatives. I only said we had this evidence from quite a large number of people incidentally in the course of some enquiries, the object of which was slightly different.

3100. Every witness who has been asked this question, has told the Commission they believe income tax prevents overtime being worked. Do you not think if you had asked the people who had been in the habit of working overtime in times gone by that they might have told you the real cause was the lack of sustaining food rather than the possibility of some tax?—I think that is also a factor, yes.

3101. I think it is a very big factor. The effect physically of working long hours without adequate sustenance is bound to have a great effect.—I entirely agree; I entirely endorse that.

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3102. And it puts up the cost. Sir Geoffrey Heyworth is here as a big employer and knows that overtime is very costly work for that very reason. Do you not think it is the same when working some variant of a piece rate system. You have this intense effort which an employee can put out for a short period, but over a long period it hampers him—I am in accord; I would add my scheme will not have much effect unless the supply of food is increased.

3103. If you take the A, B, and C examples that you gave us, it appears you have judged the case without having introduced any of the complications of the variants of piece work and their effects?—This was a simplified abstraction.

3104. It is simple as a theoretical case, but as soon as you look into it do you not get up against a lot of practical difficulties. It would be difficult to find the case you are trying to establish as a practical thing?—I do not think it would be difficult to find a case where, on the whole, the employer wanted to establish overtime and did not because he thought the labour and trouble would be too much, and on the other hand, there are cases where the employer does establish overtime. Those are my A and B. I think they are possible cases.

3105. Have you studied any of the Industrial Disputes Tribunal determinations?—Not in detail.

3106. Have you seen any?—Yes, but it is not my special subject.

3107. You have not come across one that has gone absolutely against a national agreement in the industry?—I do not follow.

3108. You say that the Tribunal would determine rates in accordance with national agreements existing and they would become legally binding on the people under the determination made against them. That was the point you made?—Up to last year.

3109. I thought you were arguing it still obtains?—I understand the Tribunal can no longer make these legally binding, but all the same you have a Tribunal which gives official recognition to an agreed rate.

3110. That is the point I am asking you.—Whether it can make that binding or not, all I want established is, is there an agreed rate or is there not? And I am submitting that over a large part of industry there is an agreed rate.

3111. You have not seen any cases, even recently, where the Tribunal has found a national agreement in operation in determining a case?—I have not followed them legally. I am not interested for my tax scheme in what the Tribunal can do. All I want to indicate is that these rates are established rates which we can take.

3112. I can tell you I sat on a case fairly recently and I was in a minority, the point being the Industrial Disputes Tribunal decides every case on its merits and creates no precedents. That is their intention. There are two other points I wanted to put to you. You do not appear to have realised in trying to put forward your scheme that industry is riddled by systems of plus rates and if you get hold of any agreement you will find this situation which is really an incentive to the workman. He starts at the bottom and the carrot is held up that if he does this, that and the other, his rate goes up. It is correct, as Sir Geoffrey Heyworth says, that only a small number of people will be found on the basic rate. Now another point, you deal with people up to £1,000 a year, have you ever thought of trying to put in some penal clauses in the sense that you put this one in for people below £1,000, for those in managerial jobs who slip off to Leeds or to Epsom, have you ever thought of doing that? You are going to penalise the man who says for certain reasons he is not going to work overtime?—These people who go to Leeds do not escape tax by doing that. A man receives £700 a year and he is going to pay tax on that. If he goes off to Leeds he risks being sacked but he does not get off any tax for he is paying it on £700 and that is what I propose for the working man.

3113. Chairman: I think your aim is to launch a scheme of taxation which would be more benevolent to the zealous worker whatever the consequences might be in fact?—That is so.

Chairman: We are very much obliged to you.

The witness withdrew

Mr. P. J. D. WILES; called and examined.

MEMORANDUM SUBMITTED BY MR. P. J. D. WILES

A. Income and Profits Tax Based on replacement cost.

1. In arguing for "replacement" against "historical" cost this memorandum takes no sides in the controversy on this subject among professional accountants. A reform is suggested in the method of calculating income and profits for taxation purposes, not for the purpose of showing them in a balance sheet, profit and loss or appropriation account. Established procedures in this field would not be affected, nor the issue of the accounting controversy prejudged. There seem to the writer to be so many excellent reasons for both "historical" and "replacement" accounting that the only logical solution is to use whichever is most suitable to the purpose in hand. He is not in general competent to decide this purely professional issue, but feels that in the particular case of income and profits tax "replacement" accounting is undoubtedly right if it can be made practical. But even granted this, it is perfectly easy to present a tax payment calculated on "replacement" principles as an item in an account reckoned "historically." The only differences are that a different figure is entered opposite the word "tax," and that the replacement quota is entered in excess of the "historical" depreciation quota in excess of the line as some sort of reserve. Even this second difference is unnecessary, for the excess quota can simply go to swell the total of "profit." All that the "historical" accountant is asked to do is that profits for taxation purposes should not be computed on generally accepted, i.e., "historical" accounting principles. If necessary separate books must be kept. It is hoped that this disclaimer has entirely banished any overtones of the "historical" versus "replacement" controversy. But we must rapidly make a second disclaimer.

2. This memorandum makes no plans for a lower rate of tax on business in general. It asks that the burden be shifted from businesses showing a great excess of "replacement" over "historical" cost in their fixed assets to businesses showing a smaller excess. The total size of the burden in any year is a matter for Parliament and the Treasury. Nothing that need affect their decision in other way will be found here, as the question is quite irrelevant. It must, however, be pointed out that if the present rates of tax were retained after adopting these proposals the yield would fall. A higher standard rate of income tax, at least on unearned income, or a higher rate of profits tax, would be necessary to raise the same revenue.

3. It is true again, that lower taxes on business in general and on replacement in particular would encourage investment in fixed assets. But while it is essential to facilitate investment in the industries chiefly hit by the inequity of the present system of taxation—e.g., shipping—there seems to be no good reason for changing the proportion of our resources devoted to investment as a whole. It would be impossible to go into detail here: it suffices perhaps to say that as there is full employment an increase in investment would require a diminution in consumption, exports or rearmament, that the very inflation that raises our problem also encourages firms to invest, and that a higher fraction of the national income is devoted to investment today than before the war (this is also true of the United States and Australia, two countries suffering from inflation where taxation upon replacement cost is now being urged). The argument, then, that the present system of taxation discourages investment in general, appears to be ill-founded.

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4. It is necessary to base tax on the replacement cost of fixed assets when the general price level has risen or is rising considerably, which is the present position in this country. This assertion is not obvious or self-evidencing but can be demonstrated on several grounds:

(1) The taxation of profits based on historical costs distorts the pattern of profitability in favour of new firms (which *ex hypothesi* have bought their assets at prices equal to those now reigning), of firms which bought plant at previous periods of high prices, and of firms which spend more on repairs than on replacements and for whom in consequence replacement is a less serious matter; yet there is no logical reason why such enterprises should be favoured. We must arrange that technically similar firms with the same replacement cost and the same real profit pay the same tax, and not base the tax on irrelevant differences in historical cost. Those who bought cheap should benefit by buying cheap.

(2) Such taxation drives businessmen to obtain outside finance, which involves the economy in the perfectly real costs of obtaining such finance, for borrowing is much more expensive of administration than ploughing back. Not indeed that ploughing back is always or necessarily the right source for funds. Stock Exchange borrowing, in contrast, ensures flexibility, and a quicker flow of funds to the most profitable and therefore the most desirable activities. As a source of funds for expansion or not investment there is much to be said for a freely competitive capital market. But it would surely be wrong to swamp it with demands for more replacement finance.

(3) Even if we follow the "historical" school in entirely separating the setting aside of depreciation funds from the physical act of replacement, and insist that the purpose of depreciation is to keep intact, not the firm's machinery but the proprietor's capital, we still need to deplete on a "replacement" basis free of tax. For it is absurd and unjust that the proprietors should get back merely the money they contributed, if since then the value of money has fallen. They should receive back the real value of the money they contributed. Contrary to popular supposition, the doctrine that it is the business of the accountant to preserve the proprietor's capital intact and to ensure no more than this, lends no support to the present system of taxation. Besides, the doctrine is in itself very questionable.

(4) The capital gain made by the firm through the rise in scrap or re-sale value of its present fixed assets is quite illusory. For one thing it would be very dangerous accountancy to take note of this rise. For another such values are always well below replacement values. Thirdly, the "gain" is reckoned in depreciated money *ex hypothesi*, and thus *ex hypothesi* no real gain. The most that can be said is that it mitigates the burden of replacement very slightly—never seriously enough to compensate for the taxing away of profit. Thus even if it is wished to tax away capital gains the case before us is irrelevant.

(5) There is a tendency under "historical" accounting to confuse "historical" with real, that is "replacement" profit and thoughtlessly to distribute as dividends funds that should be put to reserve against the purchase of new equipment. If taxation were based on replacement cost each tax bill would be a *severe* sort, and such an attitude would be much more difficult to maintain. The point is purely psychological, but no weaker for that.

(6) There is a most compelling precedent in the tax free allowances for insurance, as the Colonial Sugar Refining Company, Limited point out: "It is customary to insure assets at something approaching replacement cost. A business man would be considered extremely foolish and deserving of his fate if he had his buildings and plant (acquired, for example, *peu à peu*) insured for historical money cost. If burned out he would suffer enormous irrecoverable loss of real capital and would probably go out of business. The premium to insure for current values of the fixed assets is accepted as an allowable deduction by the Commissioner. There are certain differences between insurance and depreciation but the analogy between insuring against possible loss of plant and depreciation against certain loss of the

plant is in principle a close one, and indeed emphasises the greater need of being fully 'covered' against the certain loss."

(7) A still stronger precedent is foreign practice. Belgium,† France,‡ and Italy§ allow replacement of fixed assets free of tax. While the details of these schemes cannot always be approved the fact of their operation completely rebuts the wholesale allegations of impracticability. Much of the opposition to this sort of reform is simply due to fiscal insanity.

(8) Branches of British firms in foreign countries where the sterling exchange fluctuates are already subject to analogous procedures, and home inflation is an exactly similar case.¶

5. Note that if the price level is now stationary but has been rising recently none of the above arguments lose their validity. The injustice to the firms that bought cheap compared with those that bought dear remains quite as great. Pessimism about the future level of prices is thus not in the least necessary in supporting the "replacement" principle of taxation now. The recent past gives us grounds enough. A considerable fall in prices, which if it could be relied upon would render the reform unnecessary, is of course inconceivable. Modern states are simply armed to prevent such a fall, and their economies would not permit inactivity in this direction.

6. With rises in the prices of stocks we shall deal later. We should however consider here the case of the particular fixed asset the price of which rises much more than the general level. Should the general level or the particular price be taken into account in this case? It is possible to argue that if this kind of fixed asset has become specially dear firms should buy others; indeed that if all practical substitutes are dear too, and the firm cannot make a profit, it should go out of business. The price mechanism is merely fulfilling its ordinary function of showing what lines of business should be dropped, and there is no case for specially letting such a firm off taxation. This argument is strengthened by three practical points. First, to calculate each tax bill by means of an individual price index based upon the replacement costs of particular fixed assets is a most clumsy and time-consuming procedure, and open to every sort of evasion. Secondly, when technical progress radically alters the size and kind of fixed asset required it is nearly impossible to preserve continuity in the index of replacement costs. Thirdly, by a happy dispensation of providence fixed assets in their overwhelming majority embody chiefly the same 3 things—bricks, steel and skilled labour; so their individual prices do not depart from the general level with anything like the vigour, unpredictability and frequency of the raw materials to be processed. Departures from the general level, then, even if we do not accept the theoretical and administrative onuses against allowing for them, are small and may be neglected.

7. Not only should the index be general for capital goods, but it should by parity of reasoning be general for all goods and services whatsoever. For the capital goods index may rise more than the general index, and this will increase the social opportunity cost of the investment over that which it had when it was made. The tax law should not be so devised as to conceal this from the entrepreneur, but should return him his investment in equivalent generalised purchasing power. He may better serve the public by substituting labour or raw materials for fixed assets in the new situation.

8. We turn to the actual suggestion for reform. It is that separate books should be kept for tax purposes if "historical" accounting is retained, and these books must be based on replacement cost. If "replacement" accounting wins the day, one set of books might do. But in either case the methods of "replacement" valuation hitherto recommended are clearly impossible. Current—

* Capital Erosion and the Income Tax Assentment Act, Sydney, 26th October, 1950, para. 53. I am indebted at more than one point to this pamphlet.

† See Wilks, *Oxford Institute of Statistics Bulletin*, Apr. 1950, pp. 118-9.

‡ See Nordcliffe, *The Accountant*, 25th June, 1949, pp. 332-7.

§ A new law is at present (September 1951) being discussed.

¶ English, *The Accountant*, 4th August 1951. But Mr. English appears to press his analogy much too closely.

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still less future—replacement cost cannot be worked out every year, especially not in the majority of years in which no actual replacement is undertaken. The labour involved would be too great, and the values would be mere guesswork. Again, if techniques change the old type of assets will no longer be produced: there will be no current replacement cost. The new type of machine may be on an altogether larger scale, so that some fraction of its value would appear to be the relevant magnitude. Or there may be no new type of machine—the whole industry may have folded up, leaving no criterion of replacement cost at all. It is not then surprising that accountants generally are hostile to the proposal. But this is because they are generally under the impression that there is no half-way house between depreciation based on historical cost and depreciation based on expected replacement cost at date of replacement. Our suggestion is that original cost should be currently multiplied by a general price index, to save the trouble of individual valuations. This intermediate system is best explained algebraically. Let depreciation be conducted on straight line principles at $R\%$ of original cost per annum, for simplicity. Let C be original cost and P_1, P_2, P_3, \dots the price index at the end of years 1, 2, 3, ... as a percentage of that at the beginning of the original year, which we shall call 1. Let it be assumed that the depreciation fund accumulated by the beginning of any year is *wholly invested*, so that it maintains its real value through the year, i.e., its money value rises at the same speed as prices (this assumption, which is perfectly reasonable, is an important mitigation of our scheme's cost to the Treasury*). Then it is only necessary to ensure that the tax free depreciation quota in any year should be of the same real value as it would have been under stable prices, i.e., that RC should be multiplied by P_1, P_2, \dots etc. Thus:

Year	General price index at year's end	Depreciation quota	Size of depreciation fund at year's end
1	P_1	$P_1 RC$	$P_1 RC$
2	P_2	$P_2 RC$	$P_1 P_2 RC + P_1 RC = 2P_1 P_2 RC$
3	P_3	$P_3 RC$	$P_1 P_2 P_3 RC + P_1 P_2 RC + P_1 RC = 3P_1 P_2 P_3 RC$
4	P_4	$P_4 RC$	$P_1 P_2 P_3 P_4 RC + P_1 P_2 P_3 RC + P_1 P_2 RC + P_1 RC = 4P_1 P_2 P_3 P_4 RC$
5	P_5	$P_5 RC$	$P_1 P_2 P_3 P_4 P_5 RC + P_1 P_2 P_3 P_4 RC + P_1 P_2 P_3 RC + P_1 P_2 RC + P_1 RC = 5P_1 P_2 P_3 P_4 P_5 RC$

So that at the n th and last year, which is of course the $(1/R)$ th year, the fund stands at $P_n RC$, and the object of the scheme is achieved.

9. If the "reducing balance" system be used instead of the "straight line" the principles are of course unaffected. The amounts set aside in years 1, 2 and 3 are $P_1 RC, P_2 RC - R'C$, and $P_3 RC - 2R'C + R'C$. The amounts standing in the fund appropriate as before owing to the wisdom with which they were invested, and stand at the end of each year at $P_1 RC, P_2 RC - R'C, P_3 RC - 3R'C + R'C$ respectively.

10. Note that the price index is a general one, for the reasons given above, and that its relevant level is that on the day of closing the accounts.

11. The objection has been made that in the year of a severe price fall the depreciation allowances already given would be found to exceed the now lowered replacement cost, or that fraction of it which should by the year in question have been set aside. Then a taxable profit must be declared, and the tax bill goes up in a year of depression.† This bogey is completely scotched by the assumption made above that the money value of the fund already accumulated moves up and down with the level of prices. Fluctuations in it do not concern the tax collector, who, as at present, is only interested in the current depreciation quota. This will of course be smaller in a year of falling prices, but there is no harm at all in that. Nor, as we have seen, need much sleep be lost on the fear of falling prices in practice.

12. It might also be objected that if the money value of the fund is admitted to move with the price level nothing more need be done. It is simple to show that this is

not so. For instance, if a machine costs £100 and £10 is set aside each year, by the time inflation has raised replacement cost to £150 the first £10 will, if it has been properly invested, be worth £15. This is very true, and an important mitigation of the absolute hardship of the firm that bought at £100. But the £10 quota the firm sets aside in subsequent years will not have time to rise so far as £15. The whole £150 will thus never be attained out of the depreciation fund alone, and most even of the absolute hardship remains. Moreover, the relative hardship, compared, let us say, with a firm that bought at £130, remains unaffected. For the first firm may only set aside £10 a year tax free, while the second may set aside £13; and the value of the £13 is also enhanced by inflation.

13. Yet other objections are raised by the Committee on the Taxation of Trading Profits in their Report (Cmd 8189). We may deal with their paragraphs on the subject *separately*. With their unwillingness to open up general accounting controversy (paragraphs 97-8) we fully agree, and we have studiously avoided any such thing. In paragraph 100 they claim that the reform would favour owners of businesses against, say, investors at fixed interest in Government securities, who receive no taxation relief as prices rise.* But there is in fact no parallel here at all. Unlike (practically speaking) all other kinds of income (wages might be quoted as well as interest) profit is an income net of certain costs. If our accounting system shows these costs as other than what they really are, owing to a rise in prices, profits are then wrongly defined for taxation purposes, and in this matter of definition there is no analogy with other forms of income and capital. Only when this matter of definition is decided can we treat profits on a footing with other forms of income. The maintenance of the real value of profits, wages or interest as prices rise is quite outside the scope of these proposals or indeed of accountancy at all. Nothing in these suggestions would cause more gross profit to be earned, or the proportion between gross profit and, say, wages to be other than it now tends to be. Nothing here even tends to lower the total burden of taxation on gross profits. Our object is merely to remove an anomaly quite special to the category of profits, and to redistribute the burden of taxation within that category. This is a very modest objective; the importance of our proposals has often been exaggerated and their true nature misunderstood, not least by their supporters.

14. This disposes, I believe, of the very powerful arguments put forward by Mr. Briscoe†: "Replacement cost accounting, in a world where everybody is suffering from the disharmony of inflation, singles out the immediate owners of the means of production, the equity holders, and gives them protection. . . . They have already the advantage inherent in inflation itself, that they can make an income which expands with the cost of living, for in the nature of things they are always ahead in the race. Why then should they be so specially favoured? . . . Hence replacement cost accountants, in their desire to give industrialists an honest profit, finish up by giving them an honest currency, a privilege shared by no one else in the community. . . . Money laid out on equipment and stock cannot be specially singled out for protection from the effects of inflation." But the holders of equities do not in the nature of things keep ahead, as recent history shows. The real value of dividends and of equity capital has greatly fallen since before the war, while that of wages has risen. Nor would it affect our argument if it were otherwise. For replacement costing does not guarantee anything to anybody in the sense implied. The only guarantee against inflation is a State pension linked to the cost of living index. Short of that the wage-earner is as well able to protect himself against rising prices as the equity-holder. Gross profits depend on the fortunes of trade, not government fiat, and are in no sense guaranteed. How then can net profits be guaranteed just because the Inland Revenue agrees to take more as away from some gross profits and less from others?

15. To return to the Committee, in paragraph 103 they say that such proposals "seek to compute profits for tax purposes not in terms of pounds, but of some abstract unit unspecified". This is not true of any scheme known to the author. In all schemes the unit is perfectly specific

* Cf. Colonial Sugar Refining Company, *op cit*, Appendix. The French system also appears to make this assumption: Northcliffe, *op cit*, p. 534, para. iv.

† P. F. Chambers, *Lloyd's Bank Review*, Jan. 1949, p. 9. Cf. also Wills, *Accounting Research*, Jan. 1951, p. 80.

* Cf. Gardner, *Accounting Research*, Apr. 1951, pp. 171-3.

† The Accountant, 7 July, 1951.

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[Continued]

and concrete, and it is a pound—the current pound. They continue that such proposals “certainly cannot justify the full extent of the relief proposed, for a large part of the plant and machinery now in use dates from pre-war years, and a substantial part of the wear and tear allowances which have been granted in respect of it were, therefore, in undepreciated pounds”. Our proposals, which affect only depreciation quotas set aside after the price level rose, escape this condemnation—which is indeed valid for certain other proposals.

16. In paragraph 104 we read: “A feature of all revaluation schemes is that they benefit an established and stationary business, but not a new one or any expansion of an existing one. The taxpayer who started business after the war has to finance the whole of his expenditure on fixed assets at present prices either by borrowing or by saving out of taxed income; the man who acquired fixed assets before the war would, however, be allowed to finance part of the cost of replacing these assets out of tax-free profits”. And further “we cannot accept the view that the owner of an existing business who seeks to replace his plant is entitled to preferential treatment over a taxpayer who does not at present carry on any business, but is saving in order to set up in business. Moreover, a claim for revaluation based on the special importance of industry to the national wellbeing would equally justify relief to those who began business after the war”. The Committee’s own sentence in the middle of this paragraph provides sufficient refutation: “It is true that the latter may have had to provide the same amount of wealth measured in terms of real value; for though in terms of pounds he may have provided only half as much, the pounds which he provided when he bought the assets before the war were worth twice as much as the pounds which the post-war business has provided”. It follows, of course, that there is no preferential treatment at all, and the objection fails to the ground completely. If a post-war pound is half a pre-war pound at one stage in the argument it must not be made equal to it at another stage. Indeed one effect of our proposals is to eliminate the preference now given, quite unjustly, to the new or expanding firm, as we pointed out above.

17. In paragraph 109 the Committee are worried that these schemes “would give a substantial allowance for obsolete plant which, though still kept in being for emergency and as a stand-by, was not in continuous or regular use”. They raise here the whole problem of how to treat the costs of stand-by plant (which need not be obsolete at all)—a problem that could hardly be less relevant to the question before us. If any depreciation is to be allowed on this plant at all (which it is as much as to say, if the purchase of it is to be regarded as a normal cost of conducting the business on its present scale, and not as an expansion), then full depreciation must be allowed. But we must not be side-tracked into this problem here.

18. In paragraph 106 the objection is raised that replacement costing requires more detailed records of the dates and historical costs of individual fixed assets than are at present usually kept. This objection is admitted. But it is only of real importance with respect to the introduction of the reform. Thereafter businesses will naturally keep the records they find it most profitable to keep, and these particular extra records would clearly also be of the greatest value for cost accounting and in judging the performance of fixed assets. So to the transitional period, and the Committee’s paragraph 105, we now turn.

19. All transitions hurt vested interests and involve injustices. Supporters of the status quo can always point to this. Injustice, say the Committee, has been irretrievably done to those who after the war despite the present method of taxation did in fact renew their plant. They could not possibly receive retrospective relief, yet they must on the whole have been the most enterprising firms. But is this an argument for continuing to do injustice to those still using their pre-war plant, be they never so unenterprising? If my house is burgled my alarm is only increased if my neighbour’s house is then also burgled. If the burglar is caught on my neighbour’s threshold I am unlikely to complain of the unfairness of fate, or to demand of the police that they permit an equality of application. Rather will I rejoice in my neighbour’s good luck, which will redound also on me, for

there is after all the future, and the burglar might have returned. Indeed the Committee seem to have forgotten the future altogether at this point, since they think the only purpose of such proposals as ours is to allow for the late war: “The relief at present in question is extended as a remedy for a specific change of circumstances, namely, the increase in the price level since 1940. Even those who rest upon the theory that the computation of profits should, in strictness, take into account all changes in the price level do not attempt to translate this view into practice except in relation to that particular change”. Nothing could be further from the truth. Wholesale prices have risen more since the war than during it, and whole seems of future income tax years stretch, we hope, in front of us. The late war is the least of reasons why taxation should be based on replacement cost. Our proposals have all changes in the price level in view, and more particularly that which is now in progress. Moreover the division into sheep and goats—the enterprising who have, and the unenterprising who have not replaced—is even more shaky than the Committee admit. For the firms that repair rather than replace, and the new firms, will be in the same position as those that have recently replaced. Yet these have no particular deserts.

20. Minor injustices during the introduction of the reform therefore weigh little in the balance. A sensible method of transition would be to allow that all assets bought in 1932 should come under the new scheme from the start, while all depreciation allowances permitted tax-free in 1951 might thereafter be also multiplied by the price index.

21. It would be perhaps not out of place to give reasons for not adopting the Italian, French and Belgian system. In these countries the Treasury allows assets in balance sheets to be written up by published co-efficients, and permits tax-free depreciation at normal rates on the values thus enhanced. The chief objection is that inflation may be continuous but the leasantry of the Treasury is inflexible: public pressure and political lobbying are required to incorporate permission for such a revaluation in the fiscal legislation of any one year. As French and Italian experience shows, moreover, another “once-for-all” concession has sooner or later to be negotiated. But the concession is really a right, and should be automatic. Moreover the co-efficients will normally be smaller than the degree of depreciation of money, for the Treasury will try to keep the concession down to the minimum, so as to conserve its revenue; whereas if a permanent and automatic scheme is accepted it will more readily adjust its revenue to changed circumstances. For instance the factor in Belgium was 2½ when prices had already risen 4 times over pre-war. The Italian factors have been in the same way deplorably low, though the French have been quite accurate. Then, unless as in the French scheme different factors are allowed for assets bought in different years, the factor will favour some assets more than others. Again the revaluation would suffer the disadvantage of being an irregular, once-for-all event; like a capital levy it would be unfamiliar, difficult to administer, and open to every sort of abuse. The present suggestion, by being automatic and continuous, avoids all these difficulties.

22. Logically the same principles should apply to raw materials and wages, which should both be counted for tax purposes on the “next-in-first-out” principle. But other considerations intervene. First, simplicity; the wage-bill for tax purposes has always been quite simply the wage-bill incurred. It has usually been incurred during the past year, and therefore at rates not far short of those now current. So the advantages of NIFO would be slight compared with the complications and the sheer burden of innovation. The second and more important point applies to raw materials as well. To base taxes on NIFO or even LIFO is to encourage firms to base prices on them. But NIFO and LIFO pricing would very greatly accelerate the wage-price spiral and the impact of higher import prices. Britain is fortunate in that NIFO and LIFO have neither been adopted on the one hand because they are logical (as in U.S.A.), nor on the other as a result of bitter experience in a runaway inflation (as in France). NIFO causes a very precious sluggishness in our distributive system which keeps prices down. Thirdly, equity between firms is less important in the case of raw materials, which all firms are buying all the time. For on the

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average each firm will buy an equal proportion of its stock at each level of prices, so that all suffer alike.

23 I am unable to decide whether these points outweigh, for raw materials, the obvious advantages of FIFO or at least LIFO as a taxation base (from the general accounting controversy we, as usual, abstain): their logic, their fairness between firms, the way they spare firms the necessity of borrowing. These are precisely the advantages of replacement costing for fixed assets, but in that case there is no effect on prices (for the vast majority of firms do in any case set prices high enough to obtain full replacement funds, even out of taxed profits). In raw materials, moreover, skill in judging short-run price fluctuations is more important, and this skill is penalised by taxation based on FIFO, which falls heaviest on those who buy cheapest. With the pros and cons so evenly balanced the *status quo* is clearly best. It will not therefore be necessary to discuss practical details.

B. The Rate of Tax-free Depreciation per Annum

24 It is the contention of this section that both Treasury and industry benefit by entire freedom in the choice of depreciation rate, even, say especially, if it is permitted to write off long lasting fixed assets in one year.* That industry benefits is obvious. For, first, freedom is always preferable, *ceteris paribus*, to restrictions. Secondly, the more the firm can charge to profits in the first year the less it has to borrow, with attendant interest charges and administrative expenses. Further, as the redemption period is shorter it will be able to borrow what it must borrow on easier terms. Best of all the psychological burden of uncertainty—a burden apt to be assumed by both borrower and lender—is lightened.

25 The Treasury on the other hand loses nothing by allowing larger rates. In the normal case the capital is merely written off more quickly, the State receiving less tax during this period and more tax thereafter. It might, however, be thought that the Treasury loses if a firm, by alleging high depreciation costs, actually makes a loss, and is allowed by the regulations to set that loss off against next year's profits. But a trivial algebraical example will show that this fear is entirely groundless. Let prices be stable and a firm buy a piece of equipment lasting $(m + n)$ years, and let its gross profit be \bar{x} for each of these years, and the rate of corporation tax be k . Under fiscal system A it is allowed to write the equipment off in m years, at a rate which entails a yearly sum

$$\bar{x}(1 + p), \text{ where } p < \frac{kn}{m} \text{ (we shall see why this must be$$

so in a moment). The value of the equipment is thus $m\bar{x}(1 + p)$. Then the firm makes a loss of $\bar{x}p$ for m years and a net profit of \bar{x} for n years. The latter is taxed, but there is no rebate from the Treasury for the loss. Total tax paid = $m\bar{x}kp$. Under fiscal system B the equipment must not be written off until the $(m + n)$ th year, and the rate of depreciation therefore entails a yearly

$$\text{sum of } \bar{x}(1 + p) \frac{m}{m + n} \text{ where, be it borne in mind,}$$

$$p < \frac{kn}{m} \text{ so that the whole is less than } \bar{x}. \text{ A net profit of } \bar{x} - m\bar{x}p \frac{m}{m + n} \text{ is made each year, and is taxed each year,}$$

* With initial allowances greater than the regular quotas we do not deal. These are simply tax-free losses by the Treasury to industry, when granted, and by industry to the Treasury when recouped. It is difficult to see the point of either process.

FURTHER MEMORANDUM SUBMITTED BY MR. P. J. D. WILES

C. The Tax-free Depletion of Minerals

1. The provisions for the taxation of mines are illogical and unfair, since sums paid for the site or the mineral rights may not be amortised tax free, unless the mine is situated overseas.*

* With certain exceptions as to transfer of assets between firms. Cf. Finance Act 1946, Sec. 22; Cmd. 615 (Colwyn Commission 1950) para. 150-156; Cmd. 7123 (Departmental Committee on Taxation and Overseas Minerals, 1949); Hansard (H. of C.) Vol. 410, Col. 2339-2366.

yielding $\bar{x}(1 - pm)$ in all. But this is smaller than the yield under system A, by an amount $\bar{x}pm$. Even supposing under system A losses in one year can be written off against profits in the next, the yield is still likely to be greater. For each year's loss that can be thus transferred to a profitable year, $\bar{x}p$ is deducted from the profits, and $\bar{x}p$ from the tax. So unless all the m years of loss are set off the Treasury is bound to gain by system A, and it can in no circumstances lose. Nor would system A yield less than system B if in the m th year the firm promptly replaced its equipment. For under system B it would then be entitled to write off the outstanding book value as obsolescence allowance, which is also tax free. Only if the large amount of the obsolescence allowance caused the firm to make a loss that year would system B yield more, for it would turn out to have been based on previous years' profits that had not really been earned.

26. The Swedish* amortisation rates show a firm group of this point. In general the firm may use what suits it likes, even to the extent of writing off machine tools in one year only—a provision so "generous" and unusual that at first one suspects a catch. But there is no catch, and no disadvantages occur in practice as a result of this well known curiosity among taxation laws. It must have largely contributed to the high level of Swedish productivity.

27. The demonstration is thus irrefutable both in theory and in practice, that free choice by the taxpayer of the rate of tax-free depreciation cannot harm and in all probability benefits the Treasury. The latter has but to survive the initial years, in which its revenues will naturally be less, to enter upon no small prosperity. It may also dispense entirely with all administrative expenses connected with the regulation of depreciation rates. It remains for us to marry this proposal with the suggestions for a replacement basis.

28. There is no impediment to the marriage. If a firm chooses to write off its plant or buildings in a single year our assumption that the fund is wisely invested and runs with the level of prices takes care of all further problems. There are no depreciation problems for the rest of the asset's life. But the firm may use its new freedom to write off at some irregular rate dictated by its trading profits. Let the historical cost be C and the amount written off in the n th year X . Then with stable prices

$\frac{X}{C}$ — is the rate of depreciation chosen for this year (on straight line principles). But if the price level compared with the date of purchase of C is now P , the proportion of historical cost written off is now $\frac{XP}{C}$.

A record is kept of the notional quotas, which are the actual quotas thus deflated by the price index, and when the total of notional quotas is C the asset is deemed fully written off for tax purposes: no further tax-free depreciation is allowed, nor should any be needed.

29. Naturally the firm is not compelled to deviate from the most rigid accounting respectability; it may continue to observe the customary Inland Revenue rules if it pleases. But freedom is never a bad thing, especially if the Treasury stands to gain by it.

28.9.1951.

* Losses cannot in fact be carried forward and set off against next year's profits in Sweden, and the system is in this respect less generous than ours.

The exception in favour of overseas mineral rights and site values is due to one practical and one theoretical argument. The practical argument is that foreign mining companies have this tax privilege and so can compete on favourable terms with British companies. Our tax law must therefore make what is in effect a countervailing subsidy, and this is no more derogatory to the logic of its principles than, say, countervailing tariffs against subsidised foreign goods derogated from the logic of free trade. The theoretical argument is put by the Colwyn

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Corporation (para. 194): they are opposed in general to relieving of tax depreciation of any mere "right to an income" not created by the expenditure of capital, such as is a mineral right, but if this right to an income has been bought from a foreigner, "for all practical taxing purposes an asset has been created by the expenditure of capital." In other words an asset not previously held by the British nation has been acquired for it, and its acquisition should be allowed tax-free depreciation. Whereas in the case of transfer between British nationals, especially of a right situated within Britain, no such acquisition has occurred.

With these arguments we do not quarrel, but the position of mineral rights and site values is really much simpler than the Commission imply. Their purchase is exactly similar to the purchase of machinery by an ordinary firm, and should qualify like it for treatment as a deductible cost. For exactly as machinery depreciates minerals are depleted, and exactly as machinery must be bought by its user before he can do business so must he buy minerals in the ground. From the point of view of the user there is no conceivable difference between these outlays, meta-physical, legal or economic. But it is the user who pays the tax; therefore the tax levied upon his profits should treat machinery and minerals alike.

2. Objections to this simple and obvious view have had various bases. It has been argued (a) that depletion is not the same as depreciation, (b) that a mineral right is like an annuity, the capital value of which may not be depreciated tax free, (c) that minerals are like houses, the depreciation of which is not tax free, (d) that to qualify mineral rights for an allowance would qualify expenditure on technical education, (e) that the minerals have not been created by the expenditure of capital, (f) that the value of the minerals cannot be exactly estimated.

(a) The line that depletion radically differs from depreciation goes back to the decision in *Lee v. Newchapel Asphalts Company* (1889 41 Ch.D.1). Mr. Lee, a shareholder, objected that the company had been paying dividends out of capital in that they had set aside no fund for the depletion of the asphalt. The court simply held that the company was *bona fide* in the circumstances in setting aside no such fund. Their chief reason for doing so was that the mine was actually more valuable at the time of the case than on the company's formation, owing to a new concession from the owner of Newchapel; there had therefore been no financially relevant depletion. Their other reasons were that the existing Acts and the articles of the company must be so interpreted. The court did not say that depletion was no loss of capital, but that it was not under the existing law such a loss of capital as would legally inhibit the distribution of dividends until it was made up.*

The consequences of *Lee v. Newchapel Asphalts* have been deplored by accountants and lawyers†. But the consequences, especially for the taxation of mines, did not logically follow from the judgment. Obvious and unsatisfactory as that is, it affords no legal precedent, let alone any rational argument, for treating depletion as other than depreciation.

(b) The Colwyn Commission (para. 193) compares a mineral right to an annuity. Inasmuch as it affords an annual income it is indeed similar, but then so is a machine. The special character of an annuity for tax purposes is not at all that it affords an annual income, but that it is a form of voluntary living upon capital, entered into by the purchaser or donor with his eyes open. If a man chooses to spend his substance on champagne he does not exclude the loss of capital from his assessable income. Neither then do we if he buys an annuity, which is but a gradual kind of champagne. But the putting up of capital for business purposes is the exact opposite of the voluntary running down of capital. One of the prime objects of business is to preserve capital, and no one would enter upon it were this not so. If the tax system were directed at eroding the capital advanced in manufacturing business everyone would admit the injustice. Why then is it not unjust when it erodes mining capital?

(c) Nor are minerals like houses or the lease of houses (ibid., para. 191, 192). This is because minerals are a quite ordinary asset but houses are for various reasons an exception. A house, to be sure, is a machine & habiter, and should logically be treated for tax purposes like a machine. But it may be objected (i) that it is administratively impossible to grant houses this relief, (ii) that they ought not to have it, and (iii) that they have it already. First, the mind boggles at every owner-occupier or holder of an unfurnished let submitting accurate estimates of his depreciation and repairs to the Inland Revenue yearly. Again houses tend to appreciate owing to external trends on the market, and it would be necessary to set this off against the depreciation—a matter of even greater complexity. Then special arrangements would have to be made for owners not living in their houses, and for estate companies. But the strongest point is that living in a house is consumption, not production. It is what net income is spent on, not what it is earned by, and therefore cannot justly rank as a cost. We might as well allow expenditure on bread to rank as a deduction. Finally what is the personal allowance but deduction of basic living costs from the gross personal income, so as to arrive at net taxable income? And may it not be claimed that minimum or "subsistence" accommodation is thus permitted as a tax-free cost?

Dwelling houses, then resemble minerals at no point.* Arguments for excluding them from relief are entirely irrelevant to minerals.

(d) The assimilation of minerals to technical education (sums spent on which may not be amortised tax free by the pupils in after life) seems so plainly absurd that it cannot detain us. It might well be argued that expenditure on such education is a legitimately deductible cost; indeed it is hard to think of a cogent refutation. But whether this is so or not such a purely personal expense could hardly less resemble the acquisition of a mineral right by a firm. (The Commission's para. 182 *infra*.)

(e) A very different sort of argument is that the minerals have not been created by any human effort; by any capital expenditure. They simply exist, and all value obtained for them is unearned increment. Why should that be tax free? (Para. 191.) But the value obtained would not be freed of tax by our proposals, for the suggestion is to relieve not the mineral seller but the mineral buyer, not the receiver of the unearned increment but the enterprise that incurs a perfectly legitimate cost. The present position is exactly as if a firm monopolising a certain type of machine were to sell it at a huge profit, and the buyer were refused tax-free depreciation on it because of the inequities of the seller. To be the victim of profiteering should cease to be an offence in the eyes of the Inland Revenue. It is really amazing that the irrelevance of the argument from unearned increment should not have been perceived.

But if we relieve mineral depletion of tax mining companies will be able to spend more. Will not the mineral owners simply charge them the whole difference, so that the company gains nothing and the unearned increment of the owner rises by the full amount of the relief? (Douglas, in HANCOCK, *loc. cit.*) First, it is quite unlikely that the unearned increment will rise by as much. The extra income of the mining company will be retained, or passed on to the mineral owner, or snatched perhaps by the mining labour, or pocketed by the company's customers in the form of lower prices, in accordance with the degree of competition, the bargaining power of the several parties and, in the first instance, existing contracts. In the short run it will undoubtedly be retained by the company, for all such windfalls go initially to profits. But secondly and more important income from the ownership of minerals is concentrated, easy to detect, easy to define and easy to tax. If the income tax relief on the company does get passed on as unearned increment the tax on ownership can be increased without difficulty. The doing of justice at one stage in no wise necessitates injustice elsewhere!

* Except their tendency to appreciate on the normal market. This objection we meet in section 6 below.

† Compare the Colwyn Commission, para. 191.

* Except if the mineral owner is a foreigner! But we have seen, and legislation has already admitted, how necessary it is to relieve British companies operating abroad.

* Compare the dictum on this case of *Furwell, J. in Bond v. Berror Harrogate*, 1902, 1 Ch. 355.

† Compare H. B. Bennett, *Accounting*, pp. 264-8 (U.S.A. 1927); *Pitman's Company Law*, 19th ed. pp. 200-204.

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[Continued]

Still less can it be argued against depletion relief that in the case of minerals "the exhaustion has been taken into account already in the price which is paid, or in the royalty for the use of the land" (Douglas, loc. cit.). For this is to imply that there is no injustice in taxing depletion, since the whole tax is in fact passed on to the mineral owner. But there is no evidence that the whole tax is so passed on, any more than that the whole relief would be passed on. As we have seen, the economic conjuncture is not normally such as to make this extreme at all likely.

Palatine gai mineralis ferat. If it is desired to strike at the owner of minerals there are good precedents for nationalisation (coal royalties were nationalised in 1938), for a development charge, or for a straight percentage tax. The mining company is an innocent party.

3. This, I believe, disposes of the theoretical case for taxing mineral depletion allowances. Before proceeding let us note that the existing exception in favour of minerals abroad is much more damaging to the whole present principle than a commonly thought. For if it is right to exempt a British company abroad because it competes with foreigners it must be right to exempt a British company owning minerals at home and concerned in the export trade. As we have seen, the taxation relief is quite as likely to be passed on to customers as to mineral owners. Such a company is indeed in far greater competition with foreigners than many a colonial company selling in the British market, which is reserved to it by imperial preference. And if our hypothetical home company not only exports, but also sells at home, it then becomes necessary to relieve other home companies that do not export at all. By parity of reasoning home companies competing with imported minerals should also be relieved.

In fact when the recommendations of the Departmental Committee (Cmd. 7723) were accepted the logical pass was sold. Indeed it was sold twice over, for the Committee, in considering the claims of "natural justice" write as follows (para. 14):

"So far as foreign mineral rights are concerned we think that the argument on grounds of justice is well founded and is supported by analogy with the treatment of royalties. . . . The argument from natural justice applies to mineral rights acquired in the past as well as to rights that may be acquired in the future."

Their definition of the argument from natural justice (para. 13) shows that they had in mind just such considerations as are the burden of this memorandum:

"It is said that the minerals in the ground are the raw materials of the mining concern whose business it is to extract, grade and sell them; and that the cost of these raw materials, being a necessary expense of the business, should be deducted in ascertaining the amount upon which the concern pays tax just as the cost of the manufacturer's raw materials is."

In other words the argument from natural justice has been admitted. But it only applies abroad. This is a queer sort of natural justice. We know that justice is blind; we now learn that she is an *émigrée*.

4. It remains to make the relief practicable. There are two difficulties. First, the value of the site and/or its unexhausted mineral content may be greater at the end than at the beginning of the accounting year, owing to movements in the price of land or the mineral itself. These must clearly be deducted from the value of depletion. Secondly, the mineral content is never really known until it is exhausted, so all rates of depletion and values for the mine are pure guesswork. Both these difficulties can be solved at a single stroke. Let the mining company pay tax on present principles until the year of its winding up, or of the exhaustion of the particular mine as the case may be. It must then sell the site, and the depletion for tax purposes is the original purchase value less this selling value. It has overstated its profits by this amount, and the Treasury therefore owes it a refund of:

depletion for tax purposes \times (profits tax plus standard rate of income tax).

Should the depletion thus calculated be a negative sum the company owes the Treasury, as is only right and proper.

It might be convenient to allow a firm an advance on this refund shortly before exhaustion or winding up, when the extent of depletion is roughly known. If the standard rate of tax varies during the life of the firm a practicable refinement would be to take the average rate. If the original owner is also the operator of the mine he gets no unearned increment through our proposals, as there is no original purchase value and therefore no depletion for tax purposes; unless he subsequently sells the mine, in which case there is of course "negative depletion", and he pays tax. Finally, if replacement be substituted for historical cost as a basis for tax-free depletion, the original purchase value must be written up by the percentage rise in the general price index in order to ascertain depletion for tax purposes.

D. Miscellaneous Concerning Depletion

1. It would surely be a good thing to qualify hotel buildings for tax-free depreciation. The hotel industry is highly competitive with foreign countries, in many of which hotels get this relief. The tourist trade is vital for our balance of payments, and the reputation of our hotels keeps many tourists away. The importance of this industry has been recognised by the Government in many ways: the British Travel and Holidays Association is subsidised; building licences are always forthcoming for hotels that look like earning dollars, and they even get off purchase tax.

Moreover, a large part of the industry has been crippled by the restrictive labour practices imposed, not by any trade union, but by the state through the Catering Wages Act. This Act is now generally admitted to be an error, and the state owes the industry reparation.

These points are far removed from abstract eternal justice. But that concept fights for us too. We saw in section 2 (c) above good reasons to exclude dwelling houses from relief. None of them apply to hotels, and it is difficult to understand how so gross a theoretical error could have been made as to confuse the business of hotel-keeping with the purely private enjoyment of a house. The Colwyn Commission have nothing to say on this, and merely argue that such buildings are subject to capital appreciation (para. 211); this is true, and the solution recommended for minerals above (Sec. 4) should be applied. It will not do to object that if hotels were relieved there would be a good case for relieving private houses. This is obviously false: if a doctor may claim depreciation on his car that is no ground for allowing it to a teacher, and no such claim has ever been raised. There is a limit to the shamelessness of taxpayers, and hotels would not be the thin end of any wedge.

Hotels, then, less those parts of them lived in by owner and staff, should be classified as industrial buildings. In the case of *realised* capital appreciation there should be a refund to the Treasury.

2. The refusal of the tax-free depreciation relief is a kind of tax. It should be used quite consciously as such, and will be found to be an extremely convenient form of taxation, much cheaper to administer than the purchase tax. For the income tax forms and returns exist anyway, and go out automatically to all businesses whatsoever. Whereas if it is required to strike at a particular commodity or activity by an excise or purchase tax it is necessary to discover the businesses concerned and issue separate forms.

The refusal of relief is at present equivalent to a purchase tax of about 50 per cent., not payable in unprofitable years. While it is more my intention to point this out than to recommend objects for it, I cannot refrain from giving two examples.

(a) *Office buildings* are at present subject to this tax. It would be as easy to relieve them as to relieve hotels, but it should surely be public policy to reduce and discourage office work. Also much revenue would be lost. I am therefore in favour of retaining this tax.

(b) *Advertising* was nearly subjected to this tax a few years ago. The objection was raised that income tax should essentially fall only on revenue net of all costs.

* The author can vouch for Sweden and Switzerland. The case is thus parallel with British mines in foreign countries, which are already relieved.

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Though mineral depletion, the depreciation of office buildings and rises in the general price level already constitute exceptions much more serious than advertising could have been, the argument is surely valid. But the argument does not destroy the case for taxing advertising—indeed it does not touch it. Into that case we shall not here enter, but if it be agreed—as is the author's strong opinion—that advertising is an ideal object of taxation, then there can be nothing wrong if

the Inland Revenue chooses to levy it in this particular way.

I therefore recommend a purchase tax on all advertising that is not purely informative (e.g., as in theatre bills and trade journals), the tax to be at the rate of approximately 50 per cent. with relief in bad years. In other words let all expenditure on "non-informative" advertising be classified as not investment for income tax purposes.

25.10.1951.

EXAMINATION OF WITNESS

3124. *Chairman*: Thank you, Mr. Wiles, for the papers that you have sent in to us. Would you just clear up one or two points for me on your first document so that I follow your arguments. You are saying in paragraph 4 that:—

"It is necessary to base tax on the replacement cost of fixed assets when the general price level has risen or is rising considerably, which is the present position in this country."

You put out a number of arguments in favour of that view. In your sub-paragraph (4) you say:—

"The capital gain made by the firm through the rise in scrap or re-sale value of its present fixed assets is quite illusory."

I am not quite clear about the point you are making there. You envisage that the firm in any particular year is still retaining and using its fixed assets?—Yes.

3125. It would be abnormal to see any adjustment made to the value of that asset for a rise in prices so long as it was retained in use, would it not?—Certainly, yes, but this argument has been put forward as a counter-argument to my whole thesis. I do not think it has been put forward by accountants.

3126. Your point is, I think, in the next sentence that it would be a very dangerous thing to give any value to that movement, because the rise in the value of the fixed assets is illusory, but you are going to use it for that purpose?—When the scrap value is realised, or if you realise some of the scrap value on re-sale of your equipment which might happen that realised capital gain is also quite illusory.

3127. I am not quite clear why you say that. Would you enlarge on that?—That is simply because it does not take into account the depreciation of the general standard of value. You have not made a gain in real terms at all. Your gain is purely in money terms.

3128. Stressing that the gain, for what it is worth in terms of money, goes against your original cost of the asset?—And that would give you an illusory capital gain or anyway an illusory small depreciation. My own case, for instance, is, I think, still worth slightly more than the purchase price paid for it, and this I regard as being illusory.

3129. It is an illusory contribution to the whole cost of the asset, that is your point, is it?—Yes.

3130. If you turn to paragraph 7, I would like to be clear what index it is that you envisage using. I see you argued before that it would really be in practice impossible to take individual indices for each kind of asset, and I quite follow that, but are you speaking there of a general index for capital goods or a general price index?—I have given some thought to this matter, and I am not clear exactly what index should be used. At present I feel that the right index would be one for all factors of production. It would be an index taking into account the rise in the cost of labour, the rise in prices of raw materials and the rise in the prices of all fixed assets, and you would get back therefore sufficient money in general terms from your investment to re-invest in factors of production, quite generally speaking. My idea is that the index should not take account simply of the rise in value of fixed assets in particular, because that might bias you either against or in favour of replacing your fixed assets by other fixed assets when the right thing might be to use more labour instead, or less labour, whatever it may be, according to how prices have risen.

3131. You make it up of three main constituents, do you?—Yes, I do not stand very dogmatically by this, but this is what I thought.

3132. Your general idea?—Yes.

3133. Raw materials?—Yes.

3134. Consumption goods?—No, not consumption goods: raw materials, labour.

3135. Labour, yes.—And fixed assets.

3136. Fixed assets, I beg your pardon.—I do not myself think that consumption goods are really relevant. On the whole one does not consider changing one's capital into consumption goods, but one does consider changing them into some other kind of producer's goods.

3137. You then go on to put forward your plan under which, if I follow you, you start with the historical cost of acquisition, then ascertain what rate of depreciation you are appropriately allowing for that particular kind of asset, and then adjust in each year the resulting figure by the factor in this index, whatever it is. Then you attach, I think, a lot of importance to the argument as to whether the depreciation found which you create by these charges each year is going itself to follow the movement of the value of money?—Yes.

3138. I am not sure that I follow the importance of these arguments. Supposing it were not right to make the assumption that you make there. How far would it affect the general validity of the method which you advocate?—I think it would drive me back on the method that I originally proposed which now seems to me to be wrong, namely, that you take the actual sum historically set aside in depreciation each year, you add up those sums which will have been set aside in, let us say, years 1, 2 and 3 supposing that you have got five years altogether, and at historical prices it is £200 you want to set aside. On my original suggestion you would set aside, let us say, £100 in year 1, £110 in year 2, and £120 in year 3. You would add that up, and that would come to £330. You would then set aside in year 4 a sum sufficient to bring you up to £400 multiplied by the index, £330 plus $x = £400$ multiplied by the index. My present suggestion is that you should simply multiply £100 by the index in each successive year, because you assume, I think reasonably, that the previous depreciation quotas have been wisely invested in assets which themselves follow the general course of prices. In my new way you would save the Treasury a certain sum of money, of course, because instead of making up for the deficiency of past depreciation quotas out of taxed profits every year, you simply make up your given basic depreciation quota multiplied by the index, and that alone is done.

3129. I am not quite happy about your assumption, I want you to satisfy me about it. You make this charge against your profits in money terms each year. There is no exact fund which is created to take care of the moneys which in your notion are set aside. They are absorbed, I suppose, in the general resources of the business. Is it safe to make your assumption, since out of the various kinds of resources of a business some would no doubt appreciate with the depreciation in the value of money, but some would not? I should not have thought that you ought to attribute the quality of appreciation to the whole of the fund—I am quite certain that it would never happen exactly.

3130. No.—You would normally invest this money in working capital of some kind, in stocks of raw materials, let us say. It is very possible that it would increase in individual instances far more than the loss in the value

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of money, and that has to be taken into account as well. I just think that in general rough justice would be done by making my assumption.

3131. If it went into, let us say, Government securities which you were keeping to provide for your replacement in the future, the argument would not, respecting that element, run true.—All the more fools they, caveat emptor, if they choose to invest in Government securities, that is their lookout.

3132. We would have to recognise it as a thing which does happen when you are providing for replacement?—Yes. I do not see why the State should be required to make allowance for the follies of individuals so long as they can invest their depreciation funds in something more profitable, and, in fact, they can. I think that that is a matter for the individuals to decide, and the State should not protect them.

3133. Would that then not be met by saying that once the State has allowed the calculation which you suggest by way of annual adjustment it should not be required to enquire further into what happens to depreciation?—Quite.

3134. That would be enough to carry your point?—Certainly.

3135. This is in paragraph 22. I have not got clearly in my own mind the significance of "next-in-first-out". I know various forms of this, but what is "next-in-first-out"?—That, I understand, I am not a very good accountant myself, is when you put down as the value of the raw materials now possessed the value in the market if you were to buy today; and "last-in-first-out" uses the most recent value at which you actually did acquire them.

3136. Under this system at the closing date of the year you ask what it would cost if you bought all the stock?—At the price then reigning.

3137. Is that used?—I cannot say. I imagine that it is used for peaking purchases in France and other countries which are accustomed to inflation, but I cannot say.

3138. Mr. Carrington: One must avoid confusion in that here "next-in-first-out" is not the basis of arriving at the figure of stock for balance sheet purposes. It is the basis of arriving at the sum to be charged in the working account, trading account, or manufacturing account, as the case may be, for the material used during the year covered by the accounts. It is a case of charging against sales the cost of materials based on present day prices.

3139. Chairman: Yes, I see. It would clearly become a contributor then to your profit?

3140. Mr. Carrington: Undoubtedly. It is a basic figure in ascertaining profit, but not a balance sheet figure.

3141. Chairman: Regarding one general statement you make in paragraph 23, I would like to know what the background of it is. You say:—

"The vast majority of firms do in any case set prices high enough to obtain full replacement funds, even out of taxed profits."

It is a large statement that; have you got material behind it?—Yes, I am sorry, I should perhaps have quoted it. It is based on calculations taken from "The Economist's" reports on firms' profits. They issue these reports covering about 700 firms' profits every year, and these figures show that the extra depreciation that should be set aside could quite easily be set aside; that is as an average, I do not say that there are not individual firms, nor even individual industries, like the shipping industry, which are not quite capable of it, but the average profits will cover it.

3142. Have you got the reference you could supply to the Secretary perhaps?—Yes, I will give him my figures.

3143. Mr. Millard Tucker: I have only got one question. I wanted to ask you, because your paper is very clear. You told the Chairman that the depreciation fund or the assets representing it would have to be invested in something which was quite gilt-edged but would itself appreciate?—Yes.

3144. Let me ask you to assume that you are the head of a business, and you have £100,000 today to invest in that type of investment. What would you do, where

would you invest it?—Normally if the scale of my business is not increasing at all, if it is not an extra £100,000, but simply the ordinary turnover of my business, and my business is a constant size, I would put it into working stocks. That is the thing that I had principally in mind.

3145. Invest it in the business?—Yes. Naturally there would be a certain problem if the business were expanding (but, of course, that is not covered by the subject of depreciation) and you had to invest extra funds, let us say, temporarily until you could put up your new factory, or something, and that would indeed create a problem.

3146. Supposing you do not want to use the money at the moment for stock purposes, where would you put the money set aside for replacement in the form of this depreciation fund?—That would depend how long I wanted just to have the funds more or less idle. It could be opportune to invest in gilt-edged if you thought that there was going to be a cheap money policy in the future, and the gilt-edged was going to go up in value; it could be a good idea, but in general I think that I would use the better sort of equity.

3147. Do not equities go up necessarily?—Not necessarily, an investment is always a risk but there is a general tendency.

3148. It is very easy to put your proposition, but I am not sure that it is so easy to carry it out in practice. At the present moment equities are not going up, they have been going down, because you have got dividend limitation, not as a matter of law, but as a matter of sheer necessity.—Of course, in a period like that when equities ceased to be a very good investment it is exceedingly probable that the price level will not be rising very fast, so the absence of a profitable outlet for the investment is likely to bring with it the absence of need to offset the fall in the value of money.

3149. Who would you go to yourself personally to find such an investment expert who would be able to advise you on all these possibilities and say, "I have looked at the whole thing over the next 20 years and this is what is likely to happen"? Can you recall anybody you would go to personally for that purpose?—You do not want the name of my stockbroker, Sir?

3150. No, I am not going to say anything about stockbrokers at all.—No, I do not think I could. I do not think I have enough experience.

3151. Sir Geoffrey Heyworth: Just continuing with this discussion that you have had with the Chairman and Mr. Millard Tucker, are we not rather getting a little out of proportion this question of the re-investment of money provided under your plan? Is it not more likely that an ordinary business will be renewing capital assets, one or other of them, most of the time?—Yes.

3152. Agreed that those capital assets renewed will not be in equal parcels, but basically there will be a parcel each year; therefore all you are concerned with obviously is the money you retain for depreciation and the first place for it to go is to provide for renewals in that year. Therefore this problem of providing for the balance of the money only applies to such a year when the actual renewal you are doing is that year is less than the depreciation, is that not the real point?—Indeed.

3153. And therefore it is not a real problem of any magnitude in most businesses, it could be in certain businesses it is true, such as shipping, where you do not necessarily buy a ship a year?—Yes.

3154. But in most businesses there is no problem as I see it, except to provide for the unavailability of your need for replacement, is that not it?—I agree entirely.

3155. Is it not also true that most businesses are expanding to some degree we hope, and therefore since it is perfectly right to allow those funds for expansion, for the time being you automatically have got another avenue of investment in any expanding business which would protect its value?—Yes.

3156. With those two outlets it seems to me there is not a tremendous problem, would you agree with that?—I would indeed.

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3157. Mr. Carrington: Would you mind turning to paragraph 11 in your paper? The second sentence says:—

"Then a taxable profit must be declared, and the tax bill goes up in a year of depression. This boggy is completely scotched by the assumption made above that the money value of the fund already accumulated moves up and down with the level of prices."

Would you mind elaborating that particular reference, what you describe as the boggy?—The boggy is this, that under my original, and to my mind, incorrect suggestion not here made, you try to have accumulated by the end of any year a sum sufficient to meet that fraction of replacement cost which now should have been accumulated. Supposing you are doing it in five years all told you try to accumulate by the end of the fourth year four-fifths of the replacement cost. Supposing at the end of year 3, prices are very high and three-fifths of replacement cost is therefore a very large sum, you then have a sharp depression, prices fall considerably, and at the end of the fourth year four-fifths of the replacement cost is a smaller sum than three-fifths was at the end of year 3, then you have to take money out of your fund and bring it into the books as ordinary profit, taxable profit, and the tax bill goes up in the year of depression. According to my new suggestion you will be simply accumulating a sum of money such that every year you set aside one-fifth multiplied by the index for that year. You never look back at what the sum is now in total, for tax purposes that is. You are not concerned with the value of the total sum. So when in your fourth year you have your sharp price depression you simply set aside a very small fraction of your one-fifth, say, 90 or 80 per cent. of the historical one-fifth instead of 120 or 100 per cent. of the historical one-fifth. Otherwise under my new scheme there is no change at all, and no notice is taken for tax purposes of the fact that the replacement cost is now falling.

3158. You do not favour, I gather, correct me if I am wrong, the adoption of LIFO, or NIFO, for stock valuation purposes, do you?—Yes, I was doubtful about it because it does seem to me there is a most precious element of retardation in a wage price spiral due to my mind to the very extraordinary habit of shopkeepers who will tell you that "you had better buy it now because the price lot in will be 10 per cent. more." This general habit of shopkeepers seems to me to be very precious, and it should not be disturbed. It is quite irrational, but so long as they are willing to behave like that and not to behave like French shopkeepers the better. Therefore I would rather discourage the adoption of any taxation system of stocks which would bring regularly to their notice the true facts of the situation. It seems to me quite contrary to the public interest that they should realise the true facts of the situation.

3159. The reason I asked the question was this, that it is very much connected with this particular point we were discussing, namely, the tax bill in a year of depression.—Yes.

3160. But as you do not advocate LIFO, I will not pursue that any further.

3161. Mr. Clerk: I do not know whether you were here when Mr. Harrod was giving evidence this morning?—Yes, part of the time.

3162. I do not want to rush you into a statement of opinion for which you are not prepared, but it occurred to me that you might have thoughts on this matter that I raised with him. You recall that Mr. Harrod objects to a continuing or repeated adjustment such as you suggest because of his fears as to the effect that would have on the attitude of the Government in its capacity as guardian of the purchasing power of the currency. Perhaps I might just quote one sentence from what he wrote for us:—

"There should be no toleration for permanent measures which serve to reduce the evil effects of inflation, since they would tend to make the State less mindful of its primary duty of preventing the occurrence of inflation altogether."

I wondered whether you would be prepared to comment on that and say why you would reject that argument?—There are measures against inflation, and there are measures against deflation. It might be quite a good thing for the State, for instance, in its attitude to inflation that is, if

Civil Service pensions were attached to the cost of living index, and that would supply the state with a strong incentive to keep the cost of living down; just as the state is usually interested in a cheap money policy, whether cheap money is for national purposes a good thing or a bad thing in any given circumstances the state will always be interested in cheap money. I suppose what Mr. Harrod probably would have said if pressed is that he meant the electronic, not the state itself. The electronic must be put in such a position that inflation is always thoroughly uncomfortable, and then it would try to avoid it, whereas if you introduced my sliding scale all over the place, and I am not recommending any more than this one, the electronic would be quite comfortable, and would not vote against inflationary Governments. But as regard the state as such I should have thought that quite a number of the sliding scales would mean the state would have to move more and not less outgo, and that as far as the Treasury is concerned it would very likely keep the Treasury in a more deflationary state of mind. That is off the cuff, I am afraid; I do not know if that exhausts the point.

3163. I gather that this is the limit of the extent to which you would go within the whole range is applying your principle of automatic adjustment?—As far as the Royal Commission on Taxation is concerned it is I think the limit, yes. I have views about persons and so on which I take I do not concern the Commission.

3164. You would reject any proposal to apply it for instance to personal allowances?—Not if inflation got very rapid indeed, no, I would not reject it, but I should have thought that under present circumstances the electoral pressures upon the Chancellor to keep the income tax mild, especially at the bottom, is quite sufficient to see that personal allowances are duly raised without having an automatic scheme as well. On the whole, I think people should remain periodically rather uncomfortable by the sudden loss of the personal allowances. I think that is a good built-in safeguard against inflation which should be retained.

3165. I just want to trouble you with one detail on your second paper, at the extreme end of the paper, and it is to do with the subject of advertising costs.—Yes.

3166. I take it that what you are advocating there is that many or a large part of the total of advertising costs incurred by businesses should be disallowed as a business expenditure?—Yes.

3167. For the purpose of assessing income tax?—Yes.

3168. You make a distinction between advertising which is purely informative, and that which is not?—Yes.

3169. Have you ever tried your hand at defining what advertising is purely informative, and what is of another character?—No.

3170. It would be a task of very great difficulty?—There are so many categories which quite clearly fall into the purely informative class; advertising inside trade journals, advertising by theatres, advertising in personal columns ("small ads." are almost invariably informative) and it occurred to me as I wrote this that some crude division into categories of that kind, not of the actual subject matter of the advertising, but according to where it was published and in what form, would probably fit the bill.

3171. You would judge it by the medium rather than the advertising?—Yes. In the case of theatres, I would judge it by the person advertising it. The fact that it is a theatre means that it is almost necessarily informative. I have not worked it out in any detail.

3172. Mr. Kilder: Mr. Wiles, you seem to have produced a lot of arguments in your paper in favour of allowing replacement cost in depreciation, a subject I take it you feel rather strongly about; when I look at the various arguments I suppose on the one side you are concerned with the equity aspect, equity to the ordinary shareholder?—Between one ordinary shareholder and another, and not to the ordinary shareholder as a class. I emphasise continually that I do not want the ordinary shareholder as a class to get any more money at all. That is a matter for the budget policy quite generally, between one ordinary shareholder and another.

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3173. Anyhow the equity aspect. Perhaps I will come back to that in a moment; but your other main point is that the present system has harmful economic consequences, is not that your major point?—No.

3174. On the efficiency of the allocation of resources?—I see, in that aspect.

3175. Yes, I am asking you what is your main point. I think my main point is both the first one of equity between shareholders, and secondly this one of the due allocation of resources.

3176. Which one would you like me to deal with first?—Whichever you like.

3177. Perhaps I will take your second one first. What is your point here? You say that it distorts the pattern of profitability?—Yes.

3178. That is point 1 in your paragraph 4 that the present system favours new firms, can you explain just what that means?—It means that a new firm has very high historical costs.

3179. Would that make its costs of production higher or lower?—It will make its tax bill lower, the costs of production are identical to those of the old firm. They both have the same replacement cost. The new firm simply happens to have higher historical costs. The replacement cost being identical the tax bill on the new firm is lower.

3180. Is not the bill on the new firm lower because it is in effect investing a larger amount of capital as measured in money?—Certainly in money, but why measure it in money?

3181. Let us perhaps put it the other way round, why not? You have not produced a single argument as far as I can see for not doing it.—The new firm simply has invested no more in real terms than the old firm. Owing to the fall in the value of money the difference between the two investments is purely illusory.

3182. The costs measure foregone alternatives, do they not?—Yes, not every time, of course. If you have a diminishing money system they do not measure foregone . . .

3183. Any time an old firm, or a new firm, makes an independent act of investment, whether that is in replacement of something or not, you would agree that thing ought to be measured solely in terms of its profitability as against alternative uses for that money at that time.—Contemporary alternatives, certainly.

3184. So that "hypones are hypones" as some economists used to say, and what is relevant for a new investment is its prospective profitability at the time the investment is made.—Yes, I do not agree that hypones are hypones, but I agree with the second statement.

3185. Now that being the case what is your worry here? Your argument is that given taxation on the basis of historical costs, new firms get an undue advantage in competition with the old firms?—Yes.

3186. Can you explain that to us? It is a very interesting point.—They pay higher taxes, they have the same replacement cost but different historical costs and the new firm pays lower taxes.

3187. It has invested more money. Yes, the money does not matter because we are not now making a contemporary comparison, and money is no longer . . .

3188. I might ask this question perhaps in two stages. I take it from something you said earlier that you are not concerned with the total level of investment?—No.

3189. You are satisfied that taxation has not much to do with it anyhow?—The total level in the economy. Within a given industry, for instance in shipping, the present taxation system is particularly hard on shipping, and particularly easy on some other industries, but the whole economy, no, I do not think it matters.

3190. Your point is that that volume of investment should be differently distributed?—Yes.

3191. New firms get too much and old firms get too little?—They get too much resources.

3192. New firms get too much resources?—That is right, to play with after they have begun.

3193. Why should that be so, because the new firms have more money than the old firms?—Yes.

3194. Where do they get it from?—From the tax collector.

3195. They get it from the tax collector after the investment is made?—Yes.

3196. What you are saying is that new firms will manage to get hold of too much of the machinery that is produced in any given year?—Yes.

3197. And leave too little to the old firms?—Yes.

3198. In order to get hold of that they must have the money to buy the new machinery.—Yes.

3199. Where do they get the money from?—They get their gross revenue in the same way as the old firm and they pay smaller taxes.

3200. Why is the new firm in a better position to spend money on machinery than the old firm?—Because it is paying smaller taxes.

3201. Because it has not existed before?—I am sorry, no, in the actual moment of foundation, I think this is the misunderstanding between us, I am not speaking of the moment of foundation, I am speaking of its subsequent life. In the subsequent years of the firm when it is paying a smaller tax bill than the firm which was founded previously it will be diverting to itself too much of the national resources.

3202. Mr. Wiles, I think this is a major point in your argument, and you do not mind if I take you up a little more on this? We do not even have to think of a new firm or an old firm. We can simply think of firms which acquire their assets at different times, is that not so?—Yes.

3203. You say a firm which has acquired its assets now is in a better position to get hold of real resources than a firm which has acquired its assets before?—Yes.

3204. But why?—Because it pays smaller taxes.

3205. In the future?—I am sorry, this is the new firm actually working now.

3206. I am trying to explain to you and to get you to agree with me on this point, that from the point of view of distribution of investment between different uses what is the future allowance on the depreciation does not matter. What matters in this is the amount of monetary resources or liquid resources firms can command?—That is right.

3207. You were saying that the firms which install their assets now at higher costs because they in future pay less taxes can now command more liquid resources?—No.

3208. Otherwise your argument does not hold.—No, a firm which last year put in its machinery now can demand back more money.

3209. When last year it used its money for investment that money in turn must have accumulated through a depreciation fund, must it not?—Or it was never used.

3210. Mr. Kaldor: It creates the same problem.

3211. Chairman: If I follow you, Mr. Wiles, you are saying that your idea is that in the years succeeding the acquisition or installation of an asset at a very high cost the firm which has done that had an advantage with regard to the resources available for it in succeeding years as against a firm which had installed its assets when prices were lower.—That is what I am trying to say.

3212. Mr. Kaldor: All that I am trying to say is that on your view old firms have to turn to outside finance and new firms do not have to turn to outside finance because they are new.—Yes.

3213. But new firms have to turn to outside finance all the more?—You are still talking about the actual year of setting up of the new firm, I am still talking of the subsequent years. During its subsequent years the new firm which has just set up has more financial resources at its disposal than the old firm which set up many years before.

3214. If in both cases you are considering the actual physical replacement of an asset and the availability of sums out of past depreciation for the purpose, and you are considering a continuous rate of inflation and rising prices,

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surely there is no difference. The firm which has replaced its assets last year had to face this problem last year.—Yes.

3215. The firm which replaces its assets next year will have to face the problem that year.—Yes.

3216. But there is absolutely no difference according to when the date of the physical act of replacement happens to take place; if the act of replacement happened recently it means that the problem has already been faced.—I think there is much substance in that. If the rate of rising prices is quite regular, which of course it never is, I think there is much substance in that point which you make. But I think another thing you must assume is that the time distribution of physical replacement is very even. Each firm must be presumed to be replacing a regular constant fraction of its capital year by year. If that is given, which of course I do not agree, and the rate of rise in prices is even which it is not, I think your point has great substance.

3217. I am not sure I agree with all your qualifications, I agree with some of them. I will leave this point, but I would like to take you up on the next point. If my point has substance here I do not believe there is very much of a distortion as far as the distribution of the real investment is concerned on the lines you mention. You then go on to your next point, (2), that it means that business men are driven to obtain outside finance.—Yes.

3218. And that involves the economy in the perfectly real costs of obtaining such finance?—Yes.

3219. I want to put to you two questions here. The first is, surely, that is only the case in so far as there are insufficient taxed profits put aside. It is not a matter of taxation, it is a matter of the size of the net profit that is put aside.—Yes, there are firms, not many of them I grant, according to the figures which I worked out, there are not very many of them, but there are some, who are driven, owing to the low level of their taxed profits, to borrow for the purpose of replacement.

3220. That may be true under any system whether there is taxation of profits or not?—Indeed, but you do not want any tax system to make it quite certain.

3221. What I am arguing with you is that I do not see the case established that the present tax is inequitable in its effects, when there is less real investment undertaken with the aid of outside finance today than there was before the war?—Certainly, yes, but there is much more for replacement.

3222. As far as the real cost of obtaining this finance is concerned it is less than it was before the war?—No, the real cost of obtaining finance for purely replacement purposes, firms which are basically sound but simply have to pay inequitable tax bills, that is a cost which . . .

3223. Are you not mistaken here when as an economist you emphasise that it is purely for replacement purposes? When a shipping company purchases a new ship, from the economic point of view, whether it is replacement of an old ship or whether it is an addition to the stock of ships in the community, is rather irrelevant to the question whether the investment should be undertaken or not?—Yes, I think that that is quite correct, that the profitability side of it, which I was not talking of, is not very relevant. What I am talking about is that the forcing of such firms on to the market and the incurring of the administrative costs of . . .

3224. Firms are forced less on to the market today than they were before the war.—That is so, is it? I do not know.

3225. Undistributed profits of companies have gone up seven and a half times, net of all taxation, while the tax-free allowances for plant and machinery have gone up by 80 per cent, and if you put the two together I think the two things have gone up five or six times.—The point that I am trying to make is this, that before the war, when you did not have a considerable and fairly continuous rise in price level only those firms borrowed who wanted to make new investments, complete changes perhaps in the manner of their business, or considerable expansions. Today the firms may have to borrow, I do not imagine for a moment that it is frequent, may have to borrow simply in order to keep going, and this seemed to me a minor waste.

3226. I think you are looking at it more from an injustice point of view, that it is rather an injustice that firms should be forced to have to borrow, merely to keep going, it does not cause a distortion in the pattern of economy?—I thought we had left that point.

3227. I was still on it.—I am sorry, I thought . . .

3228. I was trying to find out whether there is anything in this distortion.—I thought we had left distortion and were now talking about costs of borrowing.

3229. I thought your point was that if firms are forced to rely on outside finance that causes some distortion, is that not it?—No, just causes administrative costs, I think I am saying in paragraph 2, is that not it?

3230. Since the war, partly as a result of inflation, a lot of firms did jolly well and made enormous profits. Other firms did not do so well and made smaller profits. This change in the relative position of firms, and the question whether they are forced on to the market or not, has to do in a large number of cases with the weight of the general level of taxation . . .—Certainly.

3231. But not so much with this particular question of the correctness of the method of depreciation. Let us go on to equity. You rather dismissed the arguments, which I see later on you quote as having been put forward, that this reference means picking out one particular aspect of the effect of the depreciation of money and ignoring all its other aspects?—Yes.

3232. Have you considered the distortion to the economy caused by the fact that two firms may differ in financial structure even though they may be identical in every other respect and produce the same commodity? One of them, say, has capital employed which exceeds considerably the proprietor's own capital employed in the business, and has debenture or mortgage interest to pay, whereas in the other case the capital employed in the business is just the same as the proprietor's own capital, and therefore there are no loans or debentures outstanding. Surely under inflation the second firm benefits unfairly, does it not, in relation to the first firm?—Yes, certainly, that is, it benefits through decisions taken entirely voluntarily by itself and by the people who bought its debentures. These decisions were taken on both sides with open eyes, and are not the concern of the Treasury. We have here at the moment, however, before us an injustice which is the concern of the Treasury and which it could I believe alter.

3233. Never mind about the concern of the Treasury, the two injustices are in exactly the same . . .—The one is a compulsory injustice. Tax cannot be avoided; it is not a matter of free contract.

3234. Yes, it could. There was no need for the firm to invest money in plant or machinery at all.—The point is that a tax . . .

3235. It might have lent it out in the market.—The tax is not a matter of a free contract between two parties. You cannot say *caveat taxpayer*. The doctrine of *caveat emptor* has no parallel in the field of taxation, and in consequence my general decision that you should not lower the total tax burden on equity holders as a class, but it should be re-distributed, I feel that there is no valid objection to be brought against my scheme on the grounds that it does not cover debenture holders.

3236. I am sorry, you are misunderstanding my point. The question of equity between debenture holder and the ordinary shareholder was not my point. That is the point you dealt with in your paper. The point that you do not deal with in your paper is that the distortions caused by inflation are equally unjust as between different firms; they are the sort of distortions which we were talking about, and which, in my opinion, are really more important when considered in relation to differences in financial structure.—No, indeed. Since this is a taxation question I am, of course, unable to deal with that point. I have often thought that it would be a good thing if debentures in general were in some way linked with the cost of living.

3237. You are now thinking primarily as an economist?—Yes.

3238. And you are primarily worried about the distorting effect of inflation on the economy, on the efficiency and productivity of the system. You are not concerned with equity, are you? That was your point, that the

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historical cost depreciation is a bad thing, it distorts the pattern of production and efficiency. Is that not equally true, ...?—Yes.

3239. Even more true on account of the fact that companies make an undue gain on inflation in so far as they have debentures and the real value of these diminishes?—It is entirely true, it does not seem to me to be a problem so easily solved. I submit that two blocks do not make a white.

3240. Could you not apply your price index to Professor Faith's proposal? He came before the Commission last week, and he wished to revise not only depreciation allowances but also the firm's obligations?—Yes, if it is considered to be relevant to the payment of taxation I would be willing to work out such a scheme.

3241. Talking about it as an economist you realise, of course, that if you wish to maintain constant the total amount of taxation falling on the earnings of the equity shareholder, and you want to introduce this reform, the rates of tax would have to go up considerably?—Yes.

3242. You are, as fact, relieving of tax an initial part of the profit earned in any year and thereby raise the tax on the margin. In other words, you raise the rates of tax and thereby increase the taxes falling on the margin in order to relieve from tax a larger part of gross profits?—The gross revenue is being untaxed at present.

3243. The gross revenue which a firm is trying to maximize, is that it?—When you have covered your costs at present you go up straight away to paying the standard rate, and you may under my scheme, having covered your costs, go to paying a rather higher standard rate than before, that is what you mean, is it?

3244. Yes.—That is quite correct, that is a disadvantage.

3245. It is the gross revenue which the firm is trying to maximize. Depreciation is a deduction from that?—Yes.

3246. What you are suggesting is to make a bigger deduction tax-free and then raise taxes?—Yes.

3247. Per unit of profit earned?—Yes.

3248. That is a bad thing from an incentive point of view?—Yes, but it is a disadvantage which is inseparable from any such scheme.

3249. It is inseparable, but you would say that the economic effects of historical costs depreciation are so bad that they far outweigh the bad economic effects or incentives of having to raise the rates of taxation?—That is my opinion.

3250. That is your considered opinion?—Yes.

Chairman: Thank you, Mr. Wiles. We are much obliged to you.

The witness withdrew.

Mr. T. BALOGH called and examined.

MEMORANDUM SUBMITTED BY MR. T. BALOGH

SOME ECONOMIC ASPECTS OF MODERN DIRECT TAXATION

I. Introductory

In the following I shall restrict myself to the consideration of the effects of taxation on the incentive to effort (Question A.1.e) and on economic progress generally. The second problem involves an analysis of its influence on risk bearing, i.e., willingness to invest (Question A.1.f) and on the capacity to undertake commitments, i.e., the supply of capital available for risk bearing (Question A.1.g). The latter question involves also the general monetary equilibrium (Question A.1.f and g) in so far as that is determined by the relationship of saving to investment.

In order, however, to be able to treat this central theme, it is necessary to deal briefly with the causes which have given rise to the insistent demand for progressive direct taxation. This will provide a basis for deciding how far some degree of inequality of incomes represents an economic necessity, which has to be accepted if deleterious effects on economic activity and progress are not to ensue (through excessive taxation of the rich).

Summary of conclusions and recommendations

1. The distribution of income is not governed by unalterable laws but is, and can be, influenced by institutional factors. Hence the incidence of taxation even from a strictly economic point of view should be redistributive. (Part II, (a) (paras. 1-3).

2. The effect of taxation on incentive depends on the technique of taxation and the social circumstances of the taxpayer (Part II (b) (paras. 6-7). Consideration should be given to reduce the number of direct taxpayers. Alternatively, the increase in the rate of income tax should be made less abrupt, and repayments under P.A.Y.E. should be effected at specially suitable dates (ibid. para. 8 (i)). Unearned income above £2,000 should be taxed more heavily, either by a flat percentage charge on the value of the capital asset, or a flat unearned surtax on unearned income chargeable prior to the calculation of income and surtax. Relief on earned income should be extended up to a limit of (say) £10,000 p.a. (ibid. para. 8 (ii)).

3. The Commission should obtain the estimates of the Inland Revenue of tax-evasion and also the following statistics:

(a) The expenses allowed against Schedule D income other than those incurred in paying wages, of obtaining

raw materials, etc., i.e., all incidental expenses such as sales promotion, travel, entertainment, maintenance of cars, houses, etc., for employees.

(b) All expenses against professional services.

(c) All expenses against agricultural income, especially cars, servants, charges for "office space" and all depreciation allowances.

(d) Covenants made against incomes above £2,000.

(e) Trusts established in favour of minors (ibid. para. 9).

4. The concept of taxable income should be extended to realised capital gains. Special treatment of this type of income is advocated. It would be difficult without such a measure to deal logically with the definition of trading profits (ibid. para. 10).

5. Direct taxation does not necessarily reduce the overall rate of saving and investment as public saving can replace private saving (Part III (a) (paras. 11 and 12). Consideration should nevertheless be given to reinforcing the existing machinery for canalising budget surpluses into productive investment (ibid. para. 13).

6. Legislation permitting Trustees and Charities to invest in equities of defined standing might advantageously be recommended for this country (Part III (b) (para. 15).

7. General tax concessions on the undistributed profits of all businesses would strengthen the trend towards monopoly. The differential taxation of distributed profits should be discontinued after the present emergency. Tax concessions on research expenditure should be made dependent on conditions, and a scheme favouring the expansion of small firms should be considered (ibid. para. 17).

8. A reduction of risk by maintaining full employment is by far the most hopeful direction of tackling the problem of continued intensive private investment. A further step should be envisaged by building up reserves against economic (as contrasted with technical) depreciation, either by the industries themselves under Government supervision, or by the Government (Part III (c) (paras. 18 to 23).

9. Relief should be extended to fluctuating incomes by permitting the reclaiming of income and surtax overpayments resulting from these fluctuations (Part III (c) (ibid. para. 25).

10. The marginal incidence of income tax should be altered by assessing income tax on the basis of gross

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income, i.e., profit before depreciation and obsolescence, is, 100 per cent. "actual" allowance system should be introduced (ibid. para. 26).

11. Variation in the rate of taxation does not seem an effective means to combat business fluctuations (Part IV (c) (para. 28).

12. A general decrease in direct taxation is not likely to solve by itself, the problem of inflationary pressure (Part IV (b) (para. 29 to 33).

II. Taxation and Incentive

(a) The origin of the demand for redistributive taxation

1. There are two main reasons behind the demand for a greater equality in the distribution of income (and wealth) by imposing on the rich a larger share of the burden of taxation. In the first place, the existence of private property and its transmission through inheritance gives rise to incomes which are not earned as a result of an active and positive contribution to the productive process.* In the second place, which is in a certain sense connected with the first, the imperfections in the market for certain higher paid services and functions are thought to result in an unnecessarily unequal distribution even of the "earned" income.

2. In the past the level of the lowest incomes and the existing inequality in the distribution of income has been defended on the basis of what was thought to be a natural "law", any violation of which would be self-defeating. According to this view, the wage level was determined by the costs of maintenance and reproduction of the working classes. Any rise in real wages above this level was thought merely to result in a corresponding increase in the population, which would once more depress wages to the subsistence level.

3. This view was completely confounded by the development of real wages and the fall in the birth rate. It has come to be realised that the share of wages, and conversely also the level of higher incomes, cannot be derived from any simple consideration, but must be explained by the mutual interaction of a great number of complicated factors. Among the most important of these factors is the degree of competitiveness within, and the freedom of entry into, the entrepreneurial classes and the degree of organisation of labour.

4. The level of higher incomes has never been explained in similar terms. Indeed such application of that type analysis as was attempted merely showed that circularity of argument could not be avoided. Recent events have demonstrated again that the historical distribution of income and the cost of the "traditional" way of life of members of these professions plays a considerable influence, in so far as it stimulates—possibly task—collusion to attain it.

The rate of remuneration which can be obtained in private profit-earning industry is the usual justification of high managerial and professional incomes. This, however, cannot provide an explanation: the profit-earning capacity of the executives of corporations is itself, in turn, determined by the ease with which new firms can become established. Thus the conventional or historical attitude concerning the "right remuneration" or "fair profit" seems to play a determining influence.

Entrepreneurial behaviour is conditioned by experience in which business fluctuations seemed an unavoidable occurrence. The rate of profit which has come to be accepted as a minimum, in particular, is, therefore, far above the rate which is, in conditions of full employment, needed to maintain industry.

* It might be argued that the possessors of wealth contribute to the productive process by forgoing the possibility of using their wealth for immediate consumption. This, however, seems to beg the question in so far as it is the existence of laws permitting the passing of property which makes this choice possible. The further argument, however, that without this possibility the original creators of the fortune might not have "saved" (in the sense of abstaining from consumption and not necessarily in the sense of not spending their income: most of the activities of fortunes seem to have originated in capital appreciation) is, as we shall argue below, weakened by income in the importance of corporate saving and investment, which from the point of view of the individual is "enforced".

† In so far as the possession of capital enables people to obtain excessive profits in private business.

5. To sum up: the distribution of income is not governed by unalterable laws but is influenced by historical and institutional factors, conventional ideas about the standard of life befitting higher occupations, etc. Even in the case of profits, historical development, which conditions the view of entrepreneurs on the level of profits needed to maintain business (in face of business fluctuations), was of prime importance.

Hence the incidence of taxation, even from a strictly economic point of view, can and should be redistributive so as to bring about a division of incomes more consonant with social justice.

(b) The effects of progressive taxation

6. Taxation generally has two contrary effects on the taxpayer.

(i) It diminishes his real income or wealth. This tends to increase the marginal utility of income in terms of his effort and thus, in general, tends to increase his willingness to work or bear risk.

(ii) It tends to cut the real yield of any additional effort and thus tends to decrease his inclination to further effort or risk bearing.

It depends on the technique of taxation and also on the closeness of the relationship of the variation of the monetary remuneration to the marginal effort as to which of these two effects will predominate. It may be expected that taxes which diminish the average real income per unit of effort without impinging correspondingly on the marginal income will increase willingness for further effort. Progressive direct taxes fall more heavily on marginal than on average real income. If income varies with effort, progressive taxes may, therefore, reduce the incentive to additional exertion.

7. The extent to which they in fact do so depends, however, (i) on the possibility of varying the amount of effort or risk bearing by the individual taxpayer.

Furthermore, (ii) the consciousness of relation between the increase in effort and the increase in taxes, (iii) the consciousness of work, (iv) the non-monetary rewards accruing from effort as well as (v) the historic development of "conventional needs" determining the value attached to the marginal income in the different social strata, play an important role in this connection.

Individuals belong to social classes and are expected to conform to certain standards of life. Attractiveness of the marginal income will depend on the relation of total income to what might be called "the social minimum income" and its own relationship to average income. The immediate impact effect of increased taxation depends, therefore, to a large extent on whether the taxation reduces real income below the social minimum of the taxpayer or whether it merely reduces what we may call "free income" above that social minimum. In the first case, he will, if he can, try to maintain his standard of life. We must include savings, i.e., provision for the future, in the social minimum. It will thus depend on whether the income recipient is able and desires to increase his expenditure or, alternatively, whether he has fixed obligations in terms of money to implement, and/or the wish to acquire reserves against the future, whether taxation on the margin will be a deterrent or an incentive.

In the longer run the social standards might be adjusted to the (long-term) trend of income net of tax. In that case the need to maintain real income would diminish. But it is possible that the adjustment will be through harder work (or the bearing of greater risks) even in the longer run so as to maintain real income despite taxation.*

8. From this point of view the following cases should be distinguished:

(i) In the case of workers progressive income taxes will tend to act as a disincentive. This is particularly the case under conditions of full employment and rising disposable real incomes, when the marginal part of incomes is not yet considered necessary to maintain a socially minimum standard of life. Workers are then able to vary their effort both in the case of piece wages and in

* Rationing in war-time, and life in isolated communities will limit the capacity or desire for increased expenditure. A rapid increase in real income will certainly tend to diminish the value of marginal income.

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the case of time remuneration, by refusing to work overtime or even refusing to attend regularly. As against this must be mentioned that overtime and bonus payments represent a marginal incentive conditional on the performance of a certain minimum of work, thus creating strong incentive to total effort. On the other hand, workers are more likely to react to an increase of income by a decrease of effort. It depends largely on the intricacies of work, or whether it is associated with signs of "social approbation" other than cash rewards, whether an increase of income will decrease effort or vice versa. No *a priori* judgment is possible.

However, P.A.Y.E. not only makes tax payments obviously dependent on effort but results in an immediate repayment of taxes as income decreases through abstinence, and thus increases the attractiveness of periodic leisure.

An expedient which might help to reduce the adverse effect of taxation on effort is the exemption from taxation or the reduction of the rate of tax upon what might be termed incomes derived from effort additional to normal effort.* Unfortunately, even in the case of wage earners, it is extremely difficult to assess the basic "normal" income which might be adopted as the basis of income taxation irrespective of actual income. It would probably lead to evasion and abuse and might encourage concentration on "overtime" output to the detriment of overall productivity. It has, therefore, to be rejected. Consideration should therefore be given to increasing the limits of tax exemption so as to remove a greater part of the working population from direct income tax liability. The amount of income tax paid in 1948-49 by 18,025,000 taxpayers out of 20,750,000, i.e., almost nine-tenths, was £181 millions out of £1,057 millions. This measure would therefore reduce the work of the Inland Revenue authorities and permit the system to function more efficiently.† It might, alternatively, be advisable to

(a) render the increase in the rate of income tax less abrupt;

(b) effect repayments under P.A.Y.E. not currently but at specially suitable dates, e.g., before Christmas.

(ii) The force of these arguments is less in the case of higher incomes. The jobs performed are more interesting and less onerous. Moreover, the real value of these incomes after tax has been falling so that the maintenance of disposable income is likely to be regarded as more important. In the case of higher salaried personnel there are also non-monetary advantages accruing from increased effort. Managers are interested in a continuous expansion of the enterprises with which they are associated. Their standing and the security of their jobs will depend on this.

Nevertheless, for historical reasons, the burden of taxation on incomes above £2,000 p.a. does not sufficiently differentiate between earned and unearned incomes. Not only have the possessors of the latter a great advantage of having capital behind them but they are much more able to react to tax measures.

Consideration should, therefore, be given to taxing unearned income above, say, £3,000 p.a. more heavily and extending the relief now restricted to £2,000 p.a. of earned income to (say) £30,000 p.a.

The method least inimical (and possibly favourable) to risk-bearing to achieve this aim is to tax unearned income on the basis of a flat percentage charge on the value of the capital asset from which it is derived. If this should be found administratively inadvisable, a flat rate unearned income surtax should be instituted chargeable prior to calculating surtax.

9. According to all available statistics, there has been a considerable change in the distribution of post-tax income in this country. On the other hand, there seems to be no comparable shift in patterns of luxury spending. Partly, no doubt, this is explicable by capital consumption. But this can hardly wholly account for the discrepancy.

In recent years, with direct taxation increasing steeply, an increasing volume of expenditure which formerly no one would have bothered to "charge" as costs against

income is being so charged. In many cases this is perfectly legitimate. In others perhaps less so. In any case, if the trend of expenses charged by firms and individuals on "promotion", "travel", "entertainment", "cars", etc., is increasing this reduces the value of comparative statistics on the distribution of income. The authorities no doubt make some "adjustment" for the income which would formerly have been, but no longer is, assessed for tax. It would seem important for the Commission to obtain these estimates. In addition, the collection of the following statistical material might be useful:

(a) The expenses allowed against Schedule D income other than those incurred in paying wages or obtaining raw materials, etc., i.e., all incidental expenses such as sales promotion, travel, entertainment, maintenance of cars, houses, etc., for employees.

(b) All expenses against professional services.

(c) All expenses against agricultural income especially cars, servants, charges for "office spouse", and all depreciation allowances.

(d) Covenants made against incomes above £2,000.

(e) Trusts established in favour of minors.

10. The importance of unearned income in total income has not diminished as much as might have been expected as a result of the heavy death duties which have been in operation for over two generations. Such income accounts for much of the undesirable and economically unwarranted inequality of income. One of the main reasons for this, falling under the terms of reference of the Commission*, seems the appreciation of capital assets. This is in part connected with the accumulation of undistributed profits (cf. below) which, from this point of view, constitutes an evasion of surtax payment. Moreover, there can be no doubt that capital gains are increasingly regarded by individual taxpayers as part of income and spent if needed.

Consideration should therefore be given to the extension of the concept of income to realised capital gains or rather the establishment of a special category of personal unearned income. The American tax system has incorporated such a tax for a long time and valuable experiences have been gained. It is evident that if a deterrent effect on risk bearing is to be avoided (and conversely if the scope for tax evasion—through charging of losses—is not to be widened) unearned income of this type should not be consolidated with the rest of income. Capital losses should only be deductible against capital gains and not against other incomes (except, possibly, a limited sum of, say, £500 p.a.). Taxpayers, however, should be able to carry forward capital losses without time limit. The tax charged should, as in America, vary with the length of time the asset is held and be subject to a slower progression of rates than tax on other income. Special concessions (possibly complete exemption) should be made for capital gains made when owner-occupied houses are sold, provided they are replaced.

The importance of such a redefinition of income is very much increased by the fact that it has been shown that without such a measure it is difficult, if not impossible, to deal with trading profits in a logical manner without creating untaxed incomes. In all cases, e.g., mineral rights, leases, etc., in which a wasting asset is acquired the tax exemption of capital gains forces the refusal of admitting depreciation allowances.† Moreover, a decline on policy on undistributed profits ought not to be influenced by the fact that non-distribution of profits is an excellent method of surtax evasion in a system which does not tax capital gains.

III. Taxation and Economic Progress

(a) Taxation and the volume of saving

11. Inequality of income, the co-existence of extreme poverty and high incomes, was thought by classical economists to be necessitated by the needs of economic progress. They opposed increases in direct taxation, arguing that

* Another is the legal evasion of death duties through gifts and establishment of trusts passing over generations. Though based on capital can properly be regarded as a form of taxation of unearned income, their consideration seems to be excluded by the Commission.

† Cf. Cmd. 6189.

* This method was adopted in Germany.

† Consideration would have to be given to the consequential need to reduce the regressive character of total taxation (including indirect taxes) on the lowest income classes.

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this would tend to reduce capital accumulation and thereby retard the increase in productivity and thus reduced in the long run to the detriment of the poorer classes. This argument was based on assuming (mostly implicitly)

- (a) that full employment would always be maintained, i.e., that the power to save would never be wasted.

It thus overlooked the possibility that the State could—indeed—promote investment through additional expenditure even if this was covered by additional taxation when there was unemployment. This would happen if taxation diminished saving and parallel State expenditure would increase demand, and also the willingness to invest by improving profit expectations.

- (b) that the State was also unable to increase investment directly by cutting consumption expenditure by additional taxation, and by using the consequent budget surplus to promote productive investment either—

- (i) by investing the surplus productively in the public sector of the economy, or
- (ii) by repaying public debt, or
- (iii) by promoting private investment through Government sponsored finance corporations.

Thus there need be no inherent contradiction between a more equal distribution of the national income and wealth by taxation and the maintenance of rapid economic progress through a high level of saving and investment. Indeed the State might be able to enforce a higher rate of saving through taxation than would come about through the automatic interaction of individual decisions.

12. A survey of pre- and post-war development in Britain* entirely bears out this view. Though the rate of savings diminished at comparable stages of employment in the inter-war period, as compared with pre-1914, much of the potential saving power was wasted in unemployment. Post-war personal saving, on the contrary, was much lower than in the inter-war period, partly as a result of taxation; nevertheless, the ratio of gross investment to national income increased.

It is noteworthy, however, that total net investment (at home and abroad) is relatively still much below the pre-1914 rate. The relatively low level of productivity in Britain strongly suggests that it could be increased much further by increasing saving and investment. Admittedly, the immediate prospects are not favourable. Rearmament and the worsening of the terms of trade will hardly permit an increase in productive investment. In the longer run, however, the problem of speeding British economic progress will arise with redoubled force and early preparations should be made to deal with it through devoting a large portion of the increase in national income to intensified productive investment.

13. Consideration might be given, therefore, to reinforcing the existing machinery of channeling budget surpluses into productive investment. In particular,

- (i) financial organs such as the L.C.F.C. and the F.C.I. might be strengthened;
- (ii) Treasury facilities to build and lease factory buildings now restricted to Development Areas should be generalised and extended to plant;
- (iii) grants might be given under suitable conditions to the modernisation and rationalisation of industries and the introduction of standardisation.

(b) Taxation and the capacity to bear risk

14. Though the contention that direct taxation reduces the overall investment capacity of the country cannot be sustained, because private saving can be replaced by public saving, it is unquestionable that the heavy taxation of the higher incomes diminishes the flow of risk bearing capital outside existing corporations. For the savings of the lower income earners which now represent the bulk of new personal savings* have to be invested by the various agencies (insurance companies, building societies etc.) in relatively safe investments. Moreover, the capacity of quick accumulation of capital by new and small firms has also been reduced. Thus the finance of new companies or of the expansion of existing companies beyond the rate of accumulation of undistributed profits might be impeded and thus the rate or quality of productive investment impaired.

Thus the strengthening of State finance corporations advocated above seems advisable also from this point of view.

15. The risk bearing money fund might, however, be re-constituted indirectly by sale of capital assets by those willing to bear risks to others. The original risk bearers would then again be free to undertake new risky commitments. Nationalisation of industry has an important influence in this respect. When a sector of the economic system is taken over by the State this will at once and the same time decrease perpetually the demand for risk bearing capital. The nationalised industry is financed either through budget surpluses, i.e., collective saving, or by issuing fixed interest bonds, i.e., savings media free of risk (except the risk of changes in the rate of interest) which are suitable for the banking system (if liquidity is required) or for other savings institutions. Nationalisation will also once and for all increase the fund of risk-willing capital available to the rest of the economy by the amount of risk capital which is displaced in the nationalised sector and which is unwilling to remain in gilt-edged securities. Thus the discrepancy between share and bond yields will be reduced. The limitation of the field for private enterprise will make risk-willing capital more eager to enter new fields of economic activity and even to accept a relatively smaller remuneration.

16. It would, however, be highly undesirable to be dependent on nationalisation as a means of obtaining risk capital for the private sector. Attention might, therefore, be called to the legislation enacted in the main financial centres of the U.S. partly to help to overcome the dearth of risk capital. This legislation consisted of permitting trustees and charities as well as insurance companies to invest in equities of a certain standing. In conditions in which the value of money might be expected to diminish this measure is commendable in any case. Moreover, first class equities seem obviously suitable as investment for such funds in an expanding economy. Similar legislation might, therefore, advantageously be recommended for in this country.

17. Proposals have been made* to increase the investment capacity of firms and corporations by a general revision of taxes on undistributed profits. Such proposals, unless accompanied by special safeguards suggested below, would inevitably strengthen the trend towards monopoly. Even before the war it had become very difficult to obtain finance for the formation of new firms, because of the greater risk involved in new ventures. Tax remission given to old established units will, in practice, render even more difficult the finance of new companies as the old units will be able to outbid them, having had the benefit of the tax concessions. Moreover, if the encouragement of reduced taxation on undistributed profits were given unconditionally, the funds so obtained might not be used to extend real investment but to buy up competitors in order to strengthen the competitive position of the firm. This might retard economic progress by the diminution of competitive pressure.

The proposal would, in any case, short-circuit the capital market by facilitating the ploughing back profits and thus paralyse such limited capacity that market has to distribute capital between different uses according to need.

In post-war years the need for a balanced stabilisation policy led first to a restraint being imposed on dividend increases, and more recently to a differential rate of taxation of distributed profits. As a temporary measure dealing with a potential income inflation this was justified but in the longer run this differentiation in the tax rates between distributed and undistributed profits should be discontinued for analogous reasons to those stated in connection with the taxation of undistributed profits.

The concession permitting the charging of all research expenditure against income by the 1945 Finance Act, without making this concession dependent on the fulfilment of certain conditions (e.g., licensing as of right of the resultant patent), has the same effect of increasing the trend towards monopoly, especially as technical research is an investment which yields typically increasing returns to scale. Small firms are in any case handicapped because

* E.g., the F.R.I. proposals on Budget Policy (The Times, January 20th, 1947 p. 2) repeated in their comments on the Economic Survey (ibid. March 26th, 1947).

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of the increasing importance of cost reduction arising out of large scale production.

It is suggested, therefore, that tax concessions on undistributed profits should be given to small firms only to enable such firms to accumulate capital and thus foster competition.

Such a proposal might be given effect in the following way:

Firms with a capital of less than, say, £100,000, might be permitted to retain a portion, say, one-half of their income tax liability in the business free of interest. When, as a result of accumulating undistributed profits (including deferred tax liability) their capital reaches a certain limit, say, £100,000, they should have to pay future taxes in full without being called upon to repay the deferred tax liability. After a further limit is reached, say, at £1,000,000, the deferred tax liability should become due, to be paid to the Exchequer over a period of years. If the capital is lost or the firm does not expand beyond the limit laid down, no claim should arise against the owners. No doubt stringent precautions would have to be taken to prevent abuse of this concession through the formation of bogus "small" companies, etc.

(c) *Taxation and the willingness to bear risk*

18. So far we have only dealt with the effects of taxation on the supply of savings and finance. It is also suggested, however, that heavy taxation reduces the willingness to bear risks—relatively to the volume of savings.

19. Entrepreneurs when deciding on investment weigh prospective net profit after taxation, and prospective possible losses. Faced with progressive taxation entrepreneurs, it is argued, hesitate to risk their capital willingly if their losses are limited only by the size of their capital while the profits are curtailed by heavy taxation. Hence they will choose safe investments. This, it is suggested, curtails real investment.

Even if state intervention stabilised total demand at full employment levels, the effect of progressive taxation on risk bearing, either through managerial decisions, or through the market valuation of equities (i.e., the ease with which finance can be obtained), might hinder the application of innovations which are subject to specially grave risks.

20. It might be argued, of course, that under a system of heavy taxation the only chance of making considerable profits is precisely by taking risks through the large capital gains attendant on successful ventures. Furthermore, the fact that losses incurred in unsuccessful ventures under existing legislation can be set off against taxable profits is also a powerful stimulus to risk bearing by existing firms. Capital gains of businesses are not subject to tax and would not be subject to tax even if a personal capital gains tax, recommended elsewhere in this paper, were introduced, as the particular tax recommended is confined to personal capital gains*. Finally, it has been argued in the first part of this paper that the existing notion of what constitutes "fair" remuneration for risk bearing might well be excessive, because they are based on the past when business fluctuations occurred. Thus they could probably be reduced without deleterious effects of risk bearing. Entrepreneurs, if they have no alternative outlets for their capital (and control over capital experts will have to be continued for other reasons), will in time come to regard as normal a less favourable ratio of profits after tax to possible losses than that taken for granted in the past.

21. Nevertheless, measures should be envisaged which stimulate investment in risky enterprise without detrimental consequences to the distribution of the national income. In this connection two suggestions are made. In the first place, the introduction of compensation schemes might be considered to facilitate the closing down of non-viable firms. Secondly, an attempt should be made to mitigate the incidence of the tax on marginal risk bearing, i.e., increase marginal profit net of tax.

* Capital gains made by businesses in regular selling and buying operations are, of course, already subject to income and profits tax.

(d) *The distribution of risk*

22. The post-war resurgence of investment despite heavily increased taxation shows indeed that a reduction of risk is by far the most hopeful direction of tackling the problem of investment. The assurance of full employment eliminates the main risk connected with investment, that of cyclical fluctuations. So long as stability is safeguarded, there is but little reason to fear a failure of investment.

23. A further step should be envisaged, however, in view of the possible repercussions on Britain of foreign instability and of the consequent differential risks in export as contrasted with home industries which might weaken the export sector. This measure should consist of building up reserves against economic (as contrasted with technical) depression, either by the industries themselves under Government supervision, or by the Government. These reserves could be used to pay compensation (though obviously not in full) to non-essential firms suffering as a result of changes in production technique or sudden alterations in demand.† It would permit the elimination of high cost producers without nationalisation, and without general distress and bankruptcy, and thus provide a basis for continuous economic progress.†

(H) *Modification of the taxation on marginal income derived from risk bearing*

24. The second set of proposals would attempt the restoration of a more favourable risk-profit ratio by modifying the incidence of taxation on marginal risk bearing.

25. (a) In the first place, the discrimination against risk bearing implicit in the present British income tax system should be ended. Losses can be carried forward under existing laws. But income tax and surtax are assessed yearly. If incomes or profits fluctuate violently, being high one year and small (or negative) the next, the taxpayer (and shareholder) pays, under the present progressive income tax (and surtax) system, a heavier tax than those who enjoy an average but steady income of the same aggregate amount. The tax, therefore, tends to discourage risk bearing.

Too much should not be made of this impediment. A very large part of business activity is already carried on by companies rather than by individuals or by partnerships. Companies are not taxed progressively. Their shareholders on the other hand have little, if any, say in management and hold shares because they wish to obtain a higher yield. Nevertheless, share prices will be influenced by these considerations and with it the ease with which risk capital can be obtained by firms. Complaints on this score are also justified in the case of certain professional earnings.

Relief should, therefore, be extended by permitting the redeeming of income and surtax overpayments resulting from this cause. This would tend to reduce discrimination against fluctuating income.

If over a period of say five years tax liability would have been smaller if the same total income had been earned evenly, the difference in tax payments should be refunded. This method seems more equitable than the adoption of a moving average, as the latter might (if fluctuations did occur) result in tax liabilities being rather high in a bad year.

* They might also be used to grant temporary subsidies to firms to enable them to remain in production until alternative outlets could be found for manpower and capital. This latter is especially important in connection with the re-establishment of foreign markets and the use of excess capacity in certain (e.g., heavy engineering) industries for the purpose. More satisfactory safeguards than have hitherto been elaborated (e.g., the failure of the Import Duties Advisory Committee in enforcing restraints promised as a counterpart of granting tariff protection) would have to be worked out to prevent fraud and bolstering up of inefficient or hopeless industries and firms.

† The finance of compensation should preferably be borne on the General Budget and not as a charge on price; an alternative would be to put a (differential) levy on the profits of the industry itself. The latter method, however, would constitute a direct tax on profits and might have unfavourable reactions on investment.

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26. (A) In the second place, the marginal incidence of income tax should be altered by assessing income tax on corporations and firms and, possibly, on certain professional, etc. earnings on the basis of gross income, i.e., profit before depreciation and obsolescence. On the other hand, all investment in real capital irrespective of its nature should be charged against taxable income. Thus the gross profit rate on new capital investment (in existing business) is made independent of the level of income tax so long as new investment remains below the rate of gross income minus dividends, because the cost of new investment is reduced by the same proportion as the rate of tax. The scheme thus amounts to a 100 per cent. "surplus" allowance system.

The limitation of this method is that it only alters the incidence of income tax on capital which is already in the business (including undistributed profits). It does not, however, affect the risk/net profit ratio for capital which is yet "uncommitted", i.e., new savings in the hands of the public the investment of which in new ventures it would be important to encourage. It is true that the price of capital goods bought out of taxed profits would be smaller as they would rank for tax remission. But that does not alter the fact that if losses emerged in new ventures at once they would have to be borne by the "new" investor. The reduction of the expected rate of net profit after tax by progressive taxation on "first"—i.e., marginal—ventures would not be avoided. In a progressive economy where new ventures (and new firms) are needed to maintain private investment even a "modified" income tax would still deter such investment.* Combined with some sort of compensation scheme, however, as was discussed above, which would diminish the risk on "new" ventures, this revision of the tax system might be very useful.

27. (c) In former discussions the view was put forward that a substitution of a "small" flat percentage annual unearned income tax, based on the value of the capital asset for part of income tax or as a flat "surplus" on unearned income would stimulate risk bearing, as it would bear more heavily on "safe" than on "risky" incomes. If this tax were to be restricted to unearned incomes above a certain minimum it might—as we have argued above—be a useful addition to our tax system. Without this proviso it would fall heavily on the small saver who is not able to invest in higher yielding equities because of the risks involved, and should not be encouraged to do so.

IV. Taxation and the Monetary Equilibrium

(a) Taxation and economic fluctuations

28. Suggestions have also been made in favour of variations in the rate of taxation on business in order to stabilise economic activity. Apart from the general use of deficit spending (or the accumulation of surpluses) it is doubtful whether such a policy would be efficacious. The fluctuations in profit expectations determining private investment are too violent for investment to be influenced by tax concessions. In times of slump entrepreneurs will not expand industries which are already thought to be burdened with excess capacity.

Tax increases would probably be more effective in checking investment in boom periods—provided they are stiff enough. But unless they were discriminatory between industries—which is impossible in practice—they would not necessarily stop speculative over-investment in bottleneck industries, while they might check long term investment, e.g., building, essential for long term stability at full employment. Thus this method—much like old fashioned bank rate policy—is unlikely to lead to stability, as it will not be able to prevent a distortion of the real capital structure and eventually, a collapse.

(b) Taxation and inflation

29. It has been suggested that state expenditure coupled with progressive taxation of the present severity will lead to capital consumption and will thus involve a perpetual

threat of inflation. Thus the diminution of progressive taxes is urged as a deflationary measure. This is the opposite of the usual arguments against progressive taxes which, as we have seen, was that they imported a deflationary bias to the economic system by reducing the profitability of capital development.

30. In analysing this problem it should, in the first place, be realised that dissaving by individuals or the diminution of private savings is not necessarily a consequence of heavy direct taxation. Uncertainty about the future, political risks, and more especially about the future value of money is a powerful incentive to capital consumption. This cannot be obviated by tax measures.

31. If, in the second place, the reduction of the taxation falling on the rich is advocated at the cost of a budget surplus, the argument falls to the ground as the tax remission will not be fully saved, i.e., total net saving will diminish and, other things remaining equal, the inflationary pressure increase.

32. If, however, tax remission is advocated in order to reduce either the expenditure on the poor or other state expenditure, the question is whether such reduction will, or will not, have dangerous social tension as a consequence (and lead to increased inflationary pressure, e.g., through wage demands) or impair the efficiency of the State administration, etc.

33. If the rate of current saving is felt to be too low and an egalitarian distribution of income is to be safeguarded, this position, taken by itself, represents really an argument for, rather than against, taxing the rich more heavily and further strengthening the budget surplus.

10.6.1951.

APPENDIX I

The level of savings and investment in Britain 1914-1950

There can be no doubt that savings both absolutely (and relatively to national income) fell substantially in the inter-war period as compared with pre-1913 and that at the same time the economic progress of the U.K. relatively to other countries also declined. Part of this development is explained by the startling change in the country's foreign balance at a time when its traditional export markets were endangered both by the rapid progress of overseas countries and by the relative failure at home. In the most depressed (and relatively least progressive) economic branches the failure to rationalise production was at least to some extent due to the fear of increasing unemployment. It is in the protected, prosperous, and expanding industries that the increase in productivity and employment had to be looked for. It was the failure in these new industries to expand and absorb the unemployed, thus forcing (or enabling) the older industries to set their house in order without aggravating the problem of the "special" areas, which has to be explained.

In spite of this sharp relative and absolute decrease in savings the instability and the under-employment of the system increased. There is, therefore, *a priori* indication that the relative incentive to invest fell. Until 1931 it might be argued that this was mainly due to the high rates of interest. After that time (or at least after 1934, when the rationing of private capital issues for home industry was discontinued), however, that factor cannot have played a significant role.

The most striking developments were the worsening of the balance of payments which changed the positive balance of £100* millions (£160-190 millions in terms of 1924 prices) in 1911 to a negative balance of almost £80 millions (also in terms of 1924 prices) in 1938, i.e., a change of between £240-270 millions. This accounts for almost the whole of the decrease in net investment (and savings). While actual home investment fell considerably relative to national income (from 11.1 to 7.5 per cent.), absolutely it remained almost constant (with due consideration to price changes).

* Cf. Note 10 of the following Table I.

* It would be difficult to devise methods to avoid this effect without opening loopholes for abuse.

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TABLE I

National Income, Investments and Savings in Great Britain,
1911, 1924 and 1938

(in millions of £)

	1911	1924	1938
1. National income... ditto in terms of 1924 prices ...	1,988 ¹ 3,750	3,803 3,803	4,350 ¹ 4,615 ¹ 4,650 5,130
2. Investment gross ditto in terms of 1924 prices ...	505 ^{1a} 954	715 800	715 800
3. Investment net ... ditto in terms of 1924 ...	320 ^{1a} 605	475 475	275 ² (342) ⁴ (320) ² 305 (380) (355)
4. 2. as % of 1 ...	25.4		16.4
5. 3. as % of 1 ...	16.8	12.5	6.3 5.95 ^{1a} 7.4 ¹
6. Increase in home assets ... ditto in 1924 prices ...	220 396	319 319	345 (365) ³ 383 (395) ³
7. Increase in Foreign assets ... ditto in 1924 ...	100 ^{1a} (190) ^{1a} (160) ^{1a}	156 156	-70 -78
8. Undistributed profits ... ditto in 1924 prices ...	115 219	205 205	170 (240) ³ 150 (270) ³
9. " Other net saving " ... ditto in 1924 prices ...	205 386	270 270	172 190

Sources: A. L. Bowley, *The Division of the Product of Industry*, 1923; and Sir J. Stamp, *The National Income, 1924; and Studies in National Income* (N.I.E. and S.R.); *The White Paper Nos. 6520 and 6823* and N. Kaldor *The Quantitative Aspects of Full Employment Policy*. (a) The price index used was (1924 = 100) 1911 = 52.9 and 1938 = 90. This might not have been appropriate for an index of the real value of investment, especially abroad.

Under (a) distribution the valuation was based in 1911 = 65, the import price index. The terms of trade have changed almost consistently in favour of Britain.

(b) For 1911 and 1924 arrived at by subtraction; for 1938 from the White Paper.

Potential full employment savings (disregarding any impact effect on the balance of payments) might have been some £100 millions more than those actually achieved in 1938.⁴ Even if such—potential—expansion is taken into account the total thus achieved would have represented a relative fall as contrasted with 1911 in terms of the national income (from 11.1 to 9.6 per cent.) though it would have represented an expansion in absolute volume of about 12 per cent.

If we then analyse the distribution of actual savings between undivided profits and "other" private saving the result is equally striking. There was no appreciable decrease in terms of actual purchasing power in undistributed profits between 1911 and 1938. Indeed if we follow Mr. Kaldor in adjusting profits for price changes,⁵ they substantially increased (i.e., from £219 to £270 millions). It must not be forgotten, moreover, that the general movement of prices does not reflect accurately the changes in the purchasing power of sterling over capital

goods. The technical progress tending to depress the price of instruments of production of a given efficiency was marked throughout this period. On the other hand the cost of the most efficient machines available in any given industry must have increased markedly with the introduction of mass production methods.

Whatever quantitative importance we may attach to each of these quantitative factors it is certain that the undistributed profits were amply sufficient to finance such investment as was undertaken in industry in 1938. According to Cmd. 6520⁶ investment in fixed capital was as follows.

TABLE II
Private Investment at Home in 1938

(£ millions)	Gross investment	Allowances for maintenance, depreciation, etc.	Net investment
Fixed capital, works, etc.:			
(a) Public utilities ...	145	80	65
(b) Other branches of activity, including house building—			
(i) Buildings ...	360	105	255
(ii) Plant and machinery ...	120	100	20
(iii) Other fixed capital, etc. ...	65	55	10
	690	340	350

To this might be added £15 millions net and £20 millions maintenance and depreciation expenditure on highways and bridges, the inclusion or exclusion of which does not affect the argument, however. By far the largest part of home investment consisted of buildings. Of the house-building and connected public works must have absorbed at least £100 millions. More than 330,000 houses were built that year. Most of this investment must have been financed by the banks, building societies and insurance companies if not out of direct private savings. This leaves only £150 millions of net investment unaccounted for.

But undivided profits, as we saw, amounted to at least £170 millions while in the same year some £75 millions of industrial and public utility issues were made on the Stock Exchange. Apart from this, private companies with £120 millions of capital were incorporated. Part of these issues, of course, were used to pay a large part of the financial expenses involved in the transfer of property which, according to the White Paper, amounted to £66 millions in all. Some of the accumulating reserves were no doubt used for financial purposes. Given after the full allowance has been made for all these factors there were ample means in the hands of the larger companies to undertake a multiple of the investment they actually undertook and certainly all investment they wished to undertake. We must bear in mind that out of this, say, £150 millions of fixed investment (apart from buildings), at least £65 millions are accounted for by the public utilities which were, in the main, not financed by undistributed profits.

We must conclude, therefore, that there is no reason to believe that the second effect of the inter-war taxation policy, the effect of reducing the savings capacity of the taxpayer, had a deleterious effect on investment as actually undertaken by established limited liability companies. It is probable that it was the decline of the willingness to invest which was responsible for the decline in the relative quality volume of British capital equipment.

It could with more cogency be argued that the consequences of taxation might have been felt in starting or expanding new enterprises. The London market was ill-adapted to provide capital for small firms or for untried processes. In the pre-1914 period these were largely financed locally. This local market decreased or disappeared largely as a result of social changes and technical developments (the increase in size of optimum units

¹ Bowley; ² White Paper; ³ Not increase in assets; ⁴ Private net saving according to White Paper; ⁵ Net investment according to White Paper (Cmd. 6520, p. 9); if changes in the value of stocks are disregarded this rises to £365 millions; ⁶ According to Kaldor (op. cit. p. 399); ⁷ over 2; ⁸ over 2; ⁹ Net private saving including tax reserve; ¹⁰ According to Bowley foreign investment amounted to £294 millions. In that case net total investment would be £414 millions and gross investment £599 millions. In terms of 1924 prices this is equivalent to £320 (362) and £780 and £1,051 millions respectively.

¹¹ Kaldor op. cit. p. 398-9.

¹² Ibid. p. 360.

¹³ Table D, p. 9.

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of production. The decrease in "risk bearing" savings as a result of taxation might also have played some role because it partly prevented the rapid building up of small firms and partly reduced the saving out of "income" of well-to-do and enterprising individuals. The entry into industry thus became increasingly difficult. The large companies, however, which became more and more dominant, could have, but did not, make full use of their investment capacity.

Post-war developments further confirm these conclusions. According to the White Paper personal gross saving declined considerably in real terms and as a percentage of national income as compared with pre-war:

	£ million					
	1938	1946	1947	1948	1949	1950
(1) Personal Income	4,352	8,589	9,351	9,998	10,597	11,042
(2) Gross Personal Saving	222	842	394	317	351	352

If we take into account the increase in taxation falling on capital the diminution is even more striking:

	£ million					
	1938	1946	1947	1948	1949	1950
(3) Taxation on capital	78	144	164	234	253	188
(4) Net saving (2-3)	144	698	230	100	105	144
(5) 4 as per cent. of 1	2.91	7.77	1.75	1.03	1.00	1.30

Nevertheless gross capital formation sharply increased in real terms and as a fraction of the national income:

	£ million					
	1938	1946	1947	1948	1949	1950
(6) National income	5,253	9,021	9,661	10,492	11,453	11,979
(7) Gross capital formation out of income	775	1,491	1,290	2,860	2,327	2,506
(8) 7 as per cent. of 6	14.75	9.88	13.35	19.63	20.32	20.94

It should be added that these estimates have been arrived at by making provision for the appreciation of stocks. The increase is even more marked if we contrast the increase of fixed investment in plant and other fixed capital from some £250 millions before the war to £890 millions in 1950. The depreciation charges and addition to net reserves by private companies have been far above the pre-war level. The argument that depreciation allowances have not been sufficient cannot be maintained even

for the year 1948*. Since then the provisions markedly increased:

Depreciation	£ million					
	1938	1946	1947	1948	1949	1950
Initial allowances	—	143	130	121	225	260
Other allowances	457	507	665	724	802	864
Undistributed profits	171	298	470	520	485	539
Addition to free reserves after provision for stock appreciation	60	55	259	135	7	205

The continuous increase in productivity at more than double of the pre-war rate shows that the fears expressed in many quarters that taxation has further reduced the formation of capital have not been well founded.

It might be argued, of course, that an even higher rate of investment would have been needed in order to strengthen the basis of the British economic system. There is some force in this plea. But it does not by any means justify the further conclusion that tax concessions would have been the most appropriate means of enforcing higher investment; it is noteworthy that the expansion of investment took place despite sharp measures both in 1947 and 1949-50 trying to reduce it so as to diminish "inflationary" pressure. This policy was the result of the under-estimate of the expansive force inherent in a continuously fully employed economy combined with the parallel automatic deflation resulting from the increase in tax yields and corporate savings as national output expands. Had controls been maintained a further increase in investment could and would have been achieved. Indeed the distribution of the national real consumption would have been more and not less even: decontrol has in all probability increased substantially the expenditure (partly out of capital) of the higher income classes. The availability of (luxury) goods and services (including foreign travel) was a temptation difficult to resist. It is not legitimate to speak of the intensity of a given demand, exerting a given inflationary pressure against controls. Controls often work more like canals and drainage systems than like absolute dams, by diverting and reducing inflationary pressures, and thus altering the underlying situation. In short, restrictions other than price restrictions often raise not only saving but the propensity to save. There is no obvious reason why habits and tastes engendered by a free price system alone should be the "right" one. In the period immediately ahead the problem of increasing productive capital investment will obviously not arise. Indeed the task before us will unfortunately be a restriction of both consumption and private investment. Once, however, the period of rearmament is over, the problem of intensifying British economic development through a combination of taxation and investment policy will arise with redoubled force.

* Cf. the study of Dr. T. Barna, *Bulletin of the Oxford University Institute of Statistics*, Vol. 11 No. 7 and 8, July and August, 1949, p. 215.

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[Continued]

APPENDIX II

Undistributed profits and industrial concentration in Britain

No statistics based on post-war data are available on the concentration of industry. In 1935, the only year for

which certain tentative estimates have been worked out, the concentration of output in the larger units was already surprising: less than one-twentieth (4.29 per cent.) of the firms employed more than the half of the total labour force (52.17 per cent.) and produced eleven-twentieths (54.96 per cent.) of net output.

TABLE I

Number of Employees	Number of firms	Per cent.	Net output	Per cent.	Number of persons employed	Per cent.
11—49	31,756	59.67	162,597	10.14	755,895	11.43
50—99	9,459	17.77	137,575	8.57	656,237	9.11
100—499	9,722	18.27	422,280	26.34	1,993,241	27.67
500—999	1,270	2.39	197,643	12.35	878,764	12.20
1,000 +	1,101	1.99	683,612	42.63	2,879,006	39.97
	53,317	100.00	1,603,307	100.00	7,213,657	100.00

The growing unevenness in the distribution of profits provides tentative indications that the concentration movement has since taken great strides forward. In 1948-49 £2,554.2 millions trading profits have been assessed on

1,694,100 firms and traders. The distribution of these profits according to size was as follows (Hansard, Feb. 15, 1951. Col. 261-2):

TABLE II
Percentage distribution of trading profits assessed, 1948-49

Range of Profits	Totals		Individuals		Firms		Co. and LA's	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount
0—10,000	98.52	35.05	99.91	96.17	98.13	76.07	88.20	12.11
10,000—100,000	1.32	22.38	0.09	3.55	1.87	21.28	10.28	29.32
100,000 +	0.16	38.57	—	0.28	—	2.65	1.52	57.40
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
	Numbers thousand	Amount million	Numbers thousand	Amount million	Numbers thousand	Amount million	Numbers thousand	Amount million
Absolute figures	1,694.1	2,554.2	1,356.9	607.9	160.1	256.6	171.1	1,689.7

Less than one-sixtieth of the number of traders (1.48 per cent.) earned more than three-fifths of all profits. Even among companies the distribution of profits was more

concentrated than before the war. In so far as the capacity to "plough" profits back increases rapidly with increasing profits, the trend is unmistakable.

* H. Leak and Melville: *The structure of British Industry*. Journal of the Royal Statistical Society. Vol. CVIII, 1945.

EXAMINATION OF WITNESS

3251. Chairman: We are grateful to you for your memorandum, Mr. Balogh. I want to be sure with your help that I follow your argument which begins under heading II—Taxation and Incentive.—Yes.

3252. If I follow you, you are drawing our attention there to the fact that the rewards which have emerged by way of income are not unalterable and are due partly to historical and to institutional reasons?—That is so.

3253. When one compares the reward that one kind of worker gets with the reward another kind of worker gets?—Yes.

3254. That is your point?—That is so, yes.

3255. And then you go on to argue, under paragraph 5 of that heading, that as this relationship is not unalterable therefore it ought to be adjusted by taxation?—It ought to be only if people think that it is unjust.

3256. Yes, that means that you have got to have a fairly clear conception of what social justice requires by way of a minimum?—Yes.

3257. That is right, is it not?—Certainly.

3258. Of course, you would expect to get into a very highly debatable field when you proceed to try to establish what amendments social justice requires?—Certainly. Economic questions are mostly debatable. They are politically determined.

3259. What I really wanted to ask you was, accepting that, of course, it can be effected by taxation, is a system of income tax in your view a good instrument for that purpose? I think that is the aspect of the matter which perhaps we are more especially concerned with, and you rather assume that that is part of your argument.—Income tax is one means, certainly. There are other means, but I do not think the Commission is concerned with the other means.

3260. No, but what struck me at first sight, with regard to the use of income tax for this purpose, is that it is rather an indiscriminating weapon to achieve the kind of thing that you have in mind. Is there not something in that?—If we could tackle the evil at the source, and if the tackling of the evil at the source would not mean undue other sacrifices and other unpalatable consequences, I should have thought that that would be better, but the history of the last 50 years does not show that attempts to tackle this particular evil at the source by, say, abolishing private property, have led to very desirable results in other countries. Therefore I should have thought the lesser evil would be progressive direct taxation.

3261. Theoretically you could secure by legislation that persons in a particular employment were not to receive more than a stated level of return, that would be a simple way?—The level to be decided would be even more debatable and if one knows the sort of Parliamentary

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[Continued]

procedure which we are having; on the whole even if you do not take the more radical remedy but this somewhat less radical remedy, I should have thought that income tax was still the lesser evil.

3262. What strikes me about income tax, and I would like your view on it, is that, as we know it, it deals merely with quantum of income, a progressive system of quantum, but does not discriminate between the various returns, unjustified in my view, which the various people who work obtain.—No, that is so.

3263. It hits rather blindly at the level of income?—Yes, I would agree with that, but, on the other hand, one has to do with an imperfect world, and in this very imperfect world perhaps this is the most perfect instrument we have.

3264. That is your view. But there is that difficulty. Supposing you thought of a particular calling that has a strong institutional background to it, let me say a lawyer's, and suppose he is getting an unfair share of remuneration for the services, there is nothing in the income tax system which really distinguishes them from any other person who is remunerated, in my view, more properly?—I should have thought that certain monopoly aspects of incomes should be tackled in a more direct way. But I should have thought that the very problem which we have to deal with here is the inequality in earned and unearned incomes, which are not due to particular monopoly situations, but to the whole historical development in this country. For the purpose of remedying that general inequality I should have thought income tax is a very good weapon.

3265. Of course, the distinction between earned and unearned income, so far as the income tax system today recognises it, is a very small part of the total system of the progressive rates which fall upon incomes generally.—As a matter of fact I think I have pointed out the need for a greater differentiation between unearned and earned income. In paragraph 8 (ii) I am thinking that if somebody has capital obviously he can make settlements and accumulate remaining capital, and that sort of arrangement.

3266. You favour, I gather, giving a greater measure of relief to earned income above £2,000 a year?—Yes.

3267. But, as it were, taking it at the expense of a heavier tax on the unearned income?—Yes.

3268. I would like your general views about the status of unearned income in this country, because we hear a good deal about it. It includes, of course, the income from such savings as individuals have been able to achieve.—I should have thought, my Lord, that would have been very little in the last twenty years.

3269. So far as there has been saving by the individuals it includes that?—Yes.

3270. It includes, I suppose, the return which a man, who has invested money in a business which has turned into a success through his efforts, obtains from his investment?—I should have thought that also on the whole a minority.

3271. I am only trying to see what the various classes are.—I suppose one might regard all capital as the result of savings if one goes back far enough.

3272. By somebody in the past?—By somebody in the past. In that way I agree that the present capital is mainly the result of past labour.

3273. I was really thinking more, of course, of the individual concern and his effort to achieve savings and get a return from them; and it includes also, I suppose, the income of people who would in the past have contributed voluntary efforts to the service of the country?—I am not sure that I follow.

3274. I was thinking of this. Part of the activity of this country in the past has been contributed by people who have not been earning by their efforts any money, they lived on inherited money or unearned income, and, of course, it has been part of our system that we should look to them for various services in the running of the country.—Do you think, my Lord, that that is the best way of choosing those people who run the country?

3275. I am not clear at all; I only want to be clear as to whether if you regard unearned income as something which must be even further reduced than it is today, you may not endanger the total voluntary effort which the country

relies upon. What would you say to that?—I should not have thought unearned income above £2,000 contributed a particularly valuable part.

3276. You would not have thought that people who are in enjoyment of unearned income above £2,000 are fairly regarded as . . . ?—I merely say it is not an especially valuable part perhaps.

3277. I am only trying to see where, if one proceeds further at the expense of unearned income on the ground that it is a wholly unjustifiable thing under modern conditions, one gets to.—I would not say it is wholly unjustifiable, because in that case you ought to confiscate. I merely said that the amount should be reduced.

3278. Have you got any sort of estimate? I think it is up to £10,000 a year, you are going to give relief of earned income, are you not?—Yes, I should have thought that that was desirable under present circumstances.

3279. What would that mean in terms of your additional charge on unearned income?—I would not know. I should not have thought very much.

3280. That depends on the measure of relief you give to the earned income, does it not?—Yes.

3281. Let me turn back again and see if I have the earlier points. How much importance do you attach, because it appears several times in your paper, to the view that business fluctuations under contemporary conditions must be regarded as, I will not say non-existent, but not comparable with the past?—I do not think that I said that.

3282. At the end of paragraph 4 you say:—

"Entrepreneurial behaviour is conditioned by experience in which business fluctuations seemed an unavoidable occurrence. The rate of profit which has come to be accepted as a minimum, in particular, is, therefore, far above the rate which is, in conditions of full employment, needed to maintain industry."

That is rather an important point, and I think you recur to it more than once, but do you have it on the view that we have now reached a state when business fluctuations are not to be expected in the same sense as they were in the past?—My Lord, this memorandum was written nine months ago.

3283. But still we have to deal with the future.—It was written on the basis of the assumption that we had learned from the past. I may have been very much mistaken, but still I should have thought that even if people have not completely learned from the past, they have learned something from the past. I should have thought that fluctuations comparable to those in the 'thirties will be avoided.

3284. We have to recognise, have we not, that there is a special aspect of the economy of this country that it is not dependent entirely upon its internal conditions, but is dependent on external trade?—Certainly, but even there there are methods of dealing with the external situation which do not involve vast fluctuations in profits. If you are assuming that an external disequilibrium has to be remedied by a sharp deflation at home, then I should have thought that is as you say, but if you are assuming, for instance, that a sharp fluctuation abroad would be dealt with either by depreciation or by giving institutional help to exports or by control of imports and that sort of thing, obviously what I have written would still stand. It is a question of alternatives.

3285. I think, if I follow you, you are saying that, vulnerable as we are to external conditions, there are measures, which although they might be extreme ones, would tend to protect us from the worst results?—Yes.

3286. Or bad results?—Not protect, but anyway minimise. The point I wanted to bring out was that the present attitude of the entrepreneur to profits and the need for profits is derived from experience in which the State for action tended to aggravate booms and slumps and on the whole perhaps one hopes that this will not be the case, but alternative measures will be taken which should not have these extreme results on business profits.

3287. At any rate you would say that there has been what you regard as an advance in thinking about the position of the State compared with a generation ago or whatever time you like to take?—Yes.

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3288. But it would be difficult to say that the most well-intentioned State force could immunise us from this fluctuation, that would be right, would it not?—It is very difficult to use the word "immunise". I should say it is impossible to immunise, but it is not impossible to diminish or mitigate.

3289. Will you turn to the end of paragraph 8 (j)? You are throwing out a suggestion that we ought to consider increasing the limits of tax exemption so as to remove a greater part of the working population from direct income tax liability. You point out, of course, that one of the results of the movement of affairs since 1939 is that an enormous range of people have been brought into direct income tax liability who were not there before the war.—That is so.

3290. You say that it is worth considering whether you should not take them out again; but you must follow that up, must you not? Most one just regard that as a loss of the £180 million revenue, or whatever it is, which is being drawn from them, or do you envisage making it up in some other way which they would not be affected by?—I would not like to devise a future budget. I should have thought that it might depend on the circumstances of the day when this reform was instituted. Tax reform on the one hand obviously has long term structural effects which are ever present. Then also a measure of budget relief has an immediate cyclical impact effect and it would have to be different if you were faced with a boom or a slump at the time of the reform. If you took the working class, or a greater part of the working class, out of the range of income tax, in a situation in which we were under pressure in our balance of payments, the offsetting increase in revenue might have to be different from the sort of measures which you could advocate if this measure were instituted at a time when our gold reserves were increasing at an unprecedented pace. Therefore, I would not like to give detailed recommendations as to what measures I would like to see taken.

3291. What is your main ground for making the recommendation, that the weekly wage earner on the whole is not a good subject for direct taxation?—I think that the administrative expenditure and the enormous work which goes into collecting the tax has completely disproportionate small effects from every point of view. If you want to have a disinflation, and if you decided that within this disinflation you wanted to disinflate the income of that part of the population which is being taken out of income tax you can do it by other measures, but I do not think that this particular tax in the particular way that it is assessed and in the particular way it is administered is a very good tax on the basis of the old Adam Smith criteria of taxation.

3292. In that it is elaborate and an elaborately administered tax?—Yes.

3293. And that, you say, is not a sensible kind of tax to apply for a comparatively small yield you get from the small earner?—Yes. Some people, of course, think that it makes people more aware of their status as citizens and that sort of thing, but I should have thought that this indirect effect is rather minor and ought not to be put against the administrative convenience.

3294. Would you turn to paragraph 10? There is a general statement there and I take it you can only give a general answer: you end up the first part of that paragraph by saying:—

"There can be no doubt that capital gains are increasingly regarded by individual taxpayers as part of income and spent if needed."

I am stressing the words "capital gains" there, rather than the fact, which many people assume, that capital is being drawn upon by many people to maintain their standard of living and expenditure. Where do you get that impression from?—I should have thought that we could get evidence for that.

3295. You can?—If you take, for instance, the second-hand car market, and the fluctuations in Stock Exchange values, you will have a pretty good correlation.

3296. I have not got those two sets of figures in my mind. What do I get out of them? You are saying that capital gains, I stress that, are increasingly regarded by individuals as part of income.—I do not think it can be

taken as coincidence that when the Stock Exchange is booming the second-hand car market is booming and when there is a slump the second-hand car market is also slumping. It may be a coincidence but I do not think it would be.

3297. And apart from that what else do you go on?—The same thing you could say of all really first class entertainments and holidays and so on. I should have thought that there is a pretty good correlation between them.

3298. In the first footnote to that paragraph you use a phrase which we may not be using in the same sense. You say that there is the legal evasion of death duties through gifts. You mean people make gifts in fact more than five years before they die?—That is right.

3299. Evasion is a word which sometimes slips in instead of avoidance.—I apologise, yes it is avoidance, I qualified it with "legal". No offence meant.

3300. It merely is that people can, if they do it in time, part with a portion of their property, and the result will be that if they do it in the right form they will not be taxed and they will not have death duties.—That is so.

3301. Mr. Millard Tucker: But they will if the donee dies first?—That is so. On the whole, however, there is an actuarial chance against the person to whom the gift was made dying quite so soon. Also one can institute trusts which ensure even against that first death.

3302. Chairman: You go on to say at the end of the paragraph:—

"Moreover, a decision on policy on undistributed profits ought not to be influenced by the fact that non-distribution of profits is an excellent method of surtax evasion in a system which does not tax capital gains."

I would like to know really what you are thinking of there. You know the system in a small company, or private company, whatever one likes to call it, under which if it decides not to distribute a reasonable amount of its profits there is machinery by which the shareholders can be assessed to surtax and that device which you are speaking of is avoided in the case of such a company?—That is so.

3303. Going beyond that kind of company, which is rather assumed to be in the hands of a few people, to the case of a larger company, is it a relevant consideration on the managerial side whether they would save surtax for their shareholders by distributing so much profit?—I should have thought so, because those companies which have very high earnings and rather low dividend yields have a very much better chance of being able to secure capital.

3304. Yes, I follow that. No doubt it has some bearing upon the terms on which they can obtain new capital if and when they want it. Is there more in it than that?—That is very important.

3305. Non-distribution of profits is an excellent method of surtax evasion is your theme, is it not? But now you say it is only a managerial decision and in order to raise capital on better terms they may decide to be generous in their distribution. It has not got much to do with surtax evasion, has it?—It has not from the manager's side, but from the asset distribution side certainly.

3306. I am sorry, I am not following you.—From the side of distribution of assets by the private person. The fact that there are a great number of companies where this is possible enables people to escape surtax. Therefore, you see, in order to deal with the surtax problem of those people who do this type of evasion one will either have to have a tax on undistributed profits in order to force distribution and so get up to surtax, or have a capital gains tax. The Americans in the nineteen thirties tried to solve this problem by having a very stiff differential tax on undistributed profits without having a surtax on distributed profits because there was at that moment, of course, no inflationary pressure or that sort of thing in America but on the contrary a deflationary pressure. Thus they wanted to get profits distributed as much as possible in order (a) to get at the higher taxpayer, and (b) prevent the tendency to monopoly which non-distribution of profits strengthens. What I meant was that if there is no capital gains tax and if we wish to avoid people

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avoiding, or rather avoiding, surtax by a suitable arrangement of their investments, we shall have to have a tax on undistributed profits, and on the whole I do not think that it is a good thing that the Treasury should decide on this basis whether or not to institute a tax on undistributed profits, which may for other reasons be a very good thing. That problem should not be decided on the basis of dealing with surtax avoidance.

3307. Are you thinking of the decision by the investor who is a surtax payer as to what kind of company he will invest in?—That is so.

3308. I thought you were referring to the person who made a decision as to what dividends they should distribute.—No, decision here refers to the Treasury. The decision of the Treasury whether or not to have a tax on undistributed profits should not be made on the basis that there are people who can avoid surtax by this means.

3309. I follow. Could you pass on to your paragraph 22? You are saying there:—

"The post-war resurgence of investment despite heavily increased taxation shows indeed that a reduction of risk is by far the most hopeful direction of tackling the problem of investment."

It is rather an aspect of the point that we were discussing just now but I thought that the post-war resurgence of investment was really very largely re-stocking and re-creating damaged assets that arose as a result of the release of companies after the war. Indeed the E.P.T. concessions were rather directed to securing that, were they not?—Yes.

3310. And the initial allowances to some extent, too. Does what you are dealing with there bear very directly on the question, whether reduction of risk over a period of years, which one has got to consider in the business life of this country, is something which is actively stimulating the minds of business men?—I should have thought so. It seems to me that one of the dangerous aspects of the present monetary policy is that the sense of risk which was eliminated in the first six years after the war is now being re-created.

3311. Mr. Kaldor: May I just take up very briefly this last point which the Chairman raised. Your last point here was that what businessmen need most is an assured market?—I should have thought so.

3312. If they are certain of being able to sell what they produce it will need very little incentive to make them invest?—Certainly.

3313. And that question is very largely a matter of monetary policy and the general management of the economy?—Yes, I should have thought so.

3314. And not a matter of taxation?—No, the taxation does not eliminate risks; it takes profits after risk has been successfully borne.

3315. What you mean is low taxation has much less to do with the business man's attitude to investment than one or another kind of monetary policy?—I should have thought so, because after all a business man, when he invests first of all, wants to have profits, and before profits arise he is quite indifferent whether there is high or low taxation. If the business man thinks that he will not have profits, though he will not have to pay taxes on the non-existing profits, he will nevertheless not invest. If on the other hand he has a certainty of success when he invests, he will do so so long as taxation is not 100 per cent. and still retain something, and something is better than nothing.

3316. What we had after the war was a mild degree of inflation, suppressed inflation, or whatever you call it, which brought it about that the business man in general could sell all the time all that was produced, and that is enough to assure that they will invest as much or expand as fast as they can.—The figures tend to show that. I am not quite sure about the attitude of those people who say first that we have invested too much and that the country ought to have a very high rate of interest in order to suppress investment, and then at the same time ask us to have less direct taxation (especially on profits) because investment is too low; I am not quite sure how to equate those two demands.

3317. In any case you think that a policy of high interest rates could do far more to discourage investment than

if you allowed any historical replacement cost. Putting it in another way, if you reduce interest rates and stimulate investment it is more efficacious than dealing with replacement cost allowance?—It seems to have been like that, I do not know. I have only judged from the past.

3318. May I just ask you two more questions. First, you come down strongly in favour of a tax on capital gains for the reasons that you mention. Some of the witnesses, particularly Mr. Harrod who came this morning, came down against it largely on the ground that it would have deleterious effects on incentive. Do you have any views on that?—Yes, I think that if a capital gains tax were progressive in the same way as the income tax, it would certainly have that effect. It seems to me, however, that capital gains tax such as is known in America has not had in America an appreciably deterrent effect, and therefore I should have thought that there is no reason to assume that it will have in this country.

3319. Actually I suppose some people would say that in America the general level of taxation is lower than it is here, but is that true?—Yes, I mean the higher brackets in America are obviously lower than in this country, but I do not quite see the relevance of it because the problem is whether you have sufficient differentiation between capital gains taxation and direct income taxation. Provided the differentiation is big the incentive effect remains.

3320. On the matter of depreciation you would favour initial allowances rather than any other method?—Yes, I am afraid I never understood quite the proposals in favour of reckoning depreciation allowances on any other basis. As somebody who has been in business, I do not see how the theoretical schemes can be translated into business practice. I would not have been very happy to try to do so when I was in business. They look very nice theoretically, but they are, of course, quite impracticable apart from certain other objections.

3321. You would favour initial allowances as a means of stimulating investment in times of inflation?—No. In times of deflation.

3322. But a lot of these arguments are concerned with times of inflation; they say that businesses are unable to invest unless they get some relief. That is not your view?—I always understood that the problem is an inflation is how to cut down outlay including investment.

3323. You recommended somewhere in this paper 100 per cent. initial allowances?—Yes certainly, I should be in favour of that.

3324. That is a very extreme proposal; we never had in this country more than 40 per cent.—Yes, I should have thought that control of investment ought to be by different means. I am in favour of the direct controls over investment rather than by indirect monetary or taxation means. I do not think investment can be much influenced by taxation measures.

3325. It does not make very much difference what you do in that case, does it, whether you give initial allowance or whether you do not?—As a means of overcoming deflation, very little. My point in advocating 100 per cent. allowances is much more in avoiding certain distortions between investments.

3326. Distortions that are due to an inflationary process?—Not necessarily inflation, risks generally speaking. It is much better to have a thing written down and done with and thereby diminish the possible risk element in it.

3327. Professor Hicks: I would just like to ask one or two questions further to that last point. That does mean that you think that the action last year of suspending that initial allowance was a great mistake from your point of view?—From my point of view, yes, but, of course, then certain other measures would have had to be taken to counter-balance that.

3328. Would you go so far as to say that the amounts of funds which business men have in their own hands under their control at any particular moment is without effect on the amount of real investment?—I should have thought, in a situation of full employment, very little.

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3329. Does it follow in that case that profits taxation in general is without economic consequences?—Economic consequences?

3330. I mean taxation on undistributed profits.—I think taxation on undistributed profits has very important consequences as between firms, yes, certainly. You ought to distinguish between the economic consequences as to the general level of employment and as to the more intimate and subtle effects on firms or differentiating between firms. I should have thought there is very little tax on can do in the first direction, though as we have never experimented with it one cannot be quite certain. I should have thought on *a priori* grounds (which I admit are rather feeble) I should expect very little effect. If once a panic situation has arisen it seems to me there is very little you can do by promising that if you have profits they will not be taxed much because nobody expects to have any profits.

3331. But when you are seeking to restrain investment, may not the limitation of the funds of the firm have something to do with the effect of this?—Not so long as the firms are still free to go to the capital market.

3332. So long as they are free to go to the capital market, but if there are any difficulties about that it would be very different.—Measures which would induce the capital market against being at their disposal would also affect, of course, their willingness to invest even had they any means. I do not think that you can differentiate between those two. A firm of rayon manufacturers, for instance, could still go to the capital market, though at rather stiff terms. They are not going to the capital market because they have just shut down some of their factories in order to decrease their stock accumulation. Thus both the worsened terms and the unwillingness to borrow are the consequence of the same policy.

3333. May I change the subject and turn to your discussion about unearned and earned income? The proposals you make involve carrying the discrimination between earned and unearned income a very great deal further than it is carried at present. Have you considered this from the point of view of the exact definition of earned and unearned income? From the point of view of the public, there would be a great increase in the importance of the distinction, the classification of what income is reckoned as earned and what is reckoned as unearned.—No, I do not quite follow.

3334. The distinction is not, I gather, by any means altogether a simple one. There are quite a number of cases where income is reckoned on one side of a line, from the point of view of the administration of tax, but which the ordinary man, if presented with it, might think rather queer. I was thinking just how your proposals would work in practice. You are going to allow people to earn incomes up to £10,000 (let us say, managing directors or salaried managers of large concerns), and get an earned income allowance. When such a man dies and leaves such as he has been able to save in the course of his life to his widow, his widow will be having an unearned income and the full force of your savings will fall upon her. It does not seem to me quite obvious that that kind of arrangement is so equitable as is rather implied in what you say.—I should have thought that for cases of this sort one could make an equitable arrangement. It is not beyond the wit of human beings to cater for the very small number of cases, for instance one could exempt from the unearned income charge any first beneficiary after death. A sort of modified Rignoso* scheme. Moreover, one could exempt from this proposal the benefits arising out of life insurance policy providing the life insurance policy is not paid up by the accumulated capital. Obviously a great number of concessions would have to be made when it comes to detailed administration, I do not know whether you wish to go into that, I should have thought one could cater for these exemptions. I should have thought, by and large, that concerned income from personal saving, not a typical case.

3335. We do not really know, do we? We do not know what sort of people are getting unearned income.—I should have thought that the Inland Revenue statistics of the distribution of unearned income do not show on the whole that that case might be taken as typical.

* Professor Rignoso Death Duties scheme, Report of the Committee on National Debt and Taxation, Cmd. 3856.

3336. Mr. Sutherland: I just wanted to ask a few questions about this exemption of the lower income groups from income tax, paragraph 8, I think. I understand that you repudiate altogether the idea of any of these taxes on a standard week or anything of that kind as quite impracticable?—Completely impracticable; I mean it is practicable only under political conditions very different from our own in which injustice is tolerated as you know you cannot appeal. The Nazis obviously could do it extremely well. They moved the miners' earnings in the Ruhr above a certain limit from taxation at all. The Russians I am told also do it, but in both cases there are very good means of suppressing any agitation for changing the tax system at the next budget which is not within our power nor is it desirable. Therefore on the whole it seems it is politically impossible and under our circumstances completely undesirable.

3337. I suppose it might be possible to save some of this £181 millions by a rather more simple form of taxation at the lower income levels?—Obviously most of these people drink tea, most, if not all of them, smoke cigarettes. By a judicious admixture of taxes you could always have almost the same incidence without the present administrative complication and without the present marginal disincentive. One might add, perhaps, that the disruptive effect of the direct taxation at lower incomes mainly arises out of a certain administrative kink in the machinery. If repayments of taxes were to take place at certain stated dates, for instance, that is to say, if the immediate connection between decreased income and income tax repayment were cut, just as it is in the case of those whose income tax is payable on two occasions, I should have thought that the consequences of the connection would be interrupted and therefore the disincentive would disappear.

3338. Mr. Crick: I will not keep you a minute. You would prefer that as a general rule profits tax should be levied at a rate which does not differentiate between distributed and undistributed?—That is so.

3339. Would you be prepared to make the change under present conditions at this moment?—By itself no, certainly not.

3340. You would leave a differentiation at the moment?—You would have to have a series of measures to offset the income effect caused by the remission of taxation if you were to abolish the differential against dividends. Secondary dividend limitations would be one of these measures. Otherwise the relaxation of taxation would worsen the inflationary situation.

3341. I wonder if it would, because if you cancel the allowance in respect of undistributed profits the result is that all profits will be charged at 50 per cent. The presumption is that, if you remove the discrimination in favour of undistributed profits, all profits will be subject to tax at 50 per cent. neglecting the present budget changes; that I should have thought was counter-industry.—Would you think that that is the presumption? If that were the presumption that would be perhaps quite justifiable, but I should have thought personally that at the moment that would not be the presumption. That is a question of judgment and I would not like to press the point.

3342. Mr. Geoffrey Hearnshaw: I would like to go back to the point that the Chairman raised and also Mr. Kaldor, but before that could we turn back to paragraph 9 for the moment. You say:—

"According to all available statistics, there has been a considerable change in the distribution of post-tax income in this country. On the other hand, there seems to be no comparable shift in patterns of luxury spending."

What is the basis for that second statement?—By expenditure on various things like automobiles, luxury travel, luxury shops.

3343. Of course it is all a question of definition of the word "luxury" and if you take travel as a global affair...—Travelling, for instance, if you go to the South of France or say one of the little ports of Italy, you still see quite a number of English yachts and that sort of thing.

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3344. You cannot get any measurement. There is no place where that is recorded, is there?—No, but one still has quite an impression.

3345. You make a fairly definite statement, that there seems to be no comparable shift in luxury spending so that the amount of such expenditure going on is presumably as great as it was before the war.—I did not say that, I merely said there was no comparable shift.

3346. If there has been no comparable shift surely it must be the same as it was before?—No, it might be smaller, only the decrease is smaller in one than in the other. If the distribution of the post-tax consumption was the same as the distribution of post-tax income in this country, then I should have thought that we should see very few Rolls Royces, most of the hotels would be bankrupt and Bond Street would have to shut up because the maximum income which you can retain in this country is something like £6,000 or £7,000, and in my humble experience I would say on £6,000 or £7,000 you cannot splash very far, it is only worth about £3,000 pre-war, and on £3,000 pre-war you did not splash much.

3347. It is just an opinion, I think, there is no basis of measurement?—Yes, certainly; as I say, it is perfectly clear statistically that you could not possibly buy the amount of luxury output from the post-tax income; it is quite clear.

3348. Where is it clear?—Because you merely have to compare the census of statistics of the quasi-luxury articles with the statistics of post-tax income to see that it is a multiple.

3349. You have done that?—Yes.

3350. You say in paragraph 22:—

"The assurance of full employment eliminates the main risk connected with investment, that of cyclical fluctuations."

Have we any experience to show that if we eliminate the risk of fluctuations there are not new risks which will spring up?—There will be certainly, of course there will. There will still be the risk, for instance, of a very large competitor strangling you, or some such risks, but I should not have thought that that risk would be in any way comparable to the cyclical risk. I merely have to refer you to the bankruptcy statistics in a good and bad year before the war, the startling contrast between the number of bankruptcies in a good year and the number of bankruptcies in a bad year, obviously because the risk element was of a different order of magnitude, especially if you eliminate from your bankruptcy statistics the very small firms, like one-man shops, which have an average life in this country of one and a half or one and three-quarter years.

3351. Since we have never had an opportunity of having an entrepreneur operate in an economy that was not subject to inflation and not subject to steep fluctuations, I suggest we do not know what the position would be under those conditions.—I suggest that what you call inflation I would call full employment.

3352. I thought we were happy that there were two separate things which could exist independently, but that is not so?—I suspect that your use of the word "inflation" would not be very far from my use of the words "full employment". My use of the word "inflation" would mean something different.

3353. I do not know, since I have not expressed my view, how you can make that statement.—I should have thought that you had, because you said no entrepreneur had ever operated in a situation not subject to either business fluctuations or to inflation. Therefore you mean that the whole of the post-war situation in this country is one of inflation, and I should have thought that that was not so. I suspect, you see, that you use the words for at least those years after the war as inflation, whereas I would use full employment.

3354. I suggest there is an element of both in them.—I should have thought the element of inflation was decreasing to vanishing point.

3355. The point I am getting at is that it seems to be quite possible, I say I do not know the answer but I am not assuming one way or the other, that if you had a long period of full employment it is quite likely that the buying habits of people would change and there may be fluctuations in industry. . . . I should have thought that the human animal was a remarkably conservative sort of thing, and our consuming habits have not changed very much really, have they? We are still spending on food and on clothing and on housing, and though there are certain small differences in the sort of way we do it, we do it all the same.

3356. I do not want to go into the detail of it but I do not look upon it as an axiom that the elimination of cyclical fluctuations necessarily reduces the risk element, that is my point, necessarily.—I should have thought it necessarily reduces the risk; I do not know by how much. Even if I were to agree with you that there is a very serious risk of structural changes I should still think that structural changes are such slow ones, at any rate all those structural changes about which we have knowledge in history, are so slow that the impact effect of cyclical fluctuations is a very much larger element in the composite risk, and therefore I should have thought that the elimination of the cyclical element would be a very important change.

3357. Sir Geoffrey Mayhew: I think it is an important element, but I do not think we have enough knowledge to say whether it is a main element, or whether it would diminish or increase those hypothetical conditions we are talking about, full employment and inflation; we cannot say what the position would be.

3358. Mr. Greenwood: Just one thing. Will you turn to the end of paragraph 10? Can you give me some idea of the companies that you have in mind there? Are they large ones or small ones?—A decision on policy on undistributed profits ought not to be influenced by the fact . . .?—Very varied types.

3359. Can you give me one example?—Glaxo; but I could give you very many.

3360. Would you not think, when it came to capital gains, that there are a great number, such as Courtaulds, where the reverse is true, that is, they plough back a tremendous amount of profit, and yet the shares are now very much lower than they were in the years before?—I would not know.

3361. Mr. Greenwood: There are a great many; my own company is one of them. Thank you very much, I was just wondering whether you meant big companies or privately owned companies, I was not certain.

Chairman: Thank you, Mr. Balogh.

The witness withdrew

NOTE

The Commission invited certain individual witnesses to give their views on the main economic questions falling within the terms of reference. The list of questions is reproduced below.

1. To what extent is it desirable or expedient to use the taxation of incomes and profits specifically as instruments of (a) monetary policy (as by the creation of a disinflationary surplus or deliberately contrived Budget deficit), and (b) economic policy (as by measures, e.g., differential rates of profits tax, granting or withholding of "initial allowances", deferment of depreciation allowances, to encourage the ploughing back or distribution of profits or the acceleration or deferment of fixed capital expenditure)? In your view could such measures usefully discriminate between different branches of industry? Is our

present tax system basically well adapted to use in such ways? If not, are there, in your view, any particular respects in which it could be made more effective for these purposes?

2. Do you think that the underlying concept of the present system of taxing profits and income should be modified in the direction of

(a) assessing tax on the basis of personal expenditure rather than income (i.e., exempting savings from tax and taxing dis-savings);

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[Continued]

(b) including a tax on realised or unrealised capital gains;

(c) introducing an annual tax assessed on the basis of personal capital?

3. Do you think any fundamental change is desirable in the taxation of small incomes, e.g., by changing the present system of P.A.Y.E., or by exempting small incomes from ordinary income tax and substituting a simple flat rate tax or some other form of tax?

4. Do you consider that the present system of granting allowances for income tax for family circumstances is economically justifiable, or would you prefer some other method as, e.g., in France or the U.S.A.?

5. Do you favour on economic grounds increased differentiation between earned and unearned income; if so, would you bring this about by increasing the proportion of earned income that is relieved, by raising the maximum amount of the relief, by extending the relief to surtax, by imposing an additional tax on unearned income or by some other method?

6. Do you think that the present system of taxing company profits as such, whether or not they are shortly to enter into the stream of individual incomes, is justified on grounds of principle? Would you prefer a system under which income tax was levied on the incomes of individuals only and there was a separate corporation tax on company profits in place of the present system under which company profits are subjected both to income tax and profits tax?

7. Do you think that the impact of the profits tax is harmful to industrial development, and if so, is it by reason of (a) the weight of the tax; (b) the deduction of debenture interest but not of preference dividends; (c) the differential rates as between distributed and undistributed profits?

8. Do you think that the present method of computing trading profits should be modified so as to take into account changes in the value of money? If so, should the modifications apply to fixed assets, or trading stock, or both, and what form should they take? Is your conclusion based on considerations of principle, or on any view you may hold on the effects of the present system on the growth and efficiency of industry? On the latter aspect, can you point to any statistical or other factual evidence in support of your views? Do you think that any such adjustment for the change in the value of money requires that a change should also be made in fixed charges (e.g., debenture interest) payable by traders; if not, on what grounds of principle do you think that the one case can be distinguished from the other?

9. Do you think that any change should be made on economic grounds in the present rules governing allowances for business or professional expenses, whether for purposes of personal or profits taxation (e.g., advertising, entertainment, travelling, charitable subscriptions)?

10. Do you favour, under present conditions or as a general practice, the levying of a special tax on "excess" profits; and if so, in what sense should the word "excess" be interpreted, or on what basis should the taxable excess be computed?

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MINUTES OF EVIDENCE
TAKEN BEFORE THE
**ROYAL COMMISSION ON
THE TAXATION OF
PROFITS AND INCOME**

13

THIRTEENTH DAY

Friday, 4th July, 1952



WITNESSES

MR. LEO KENNETT

MR. J. E. HARRIS

} The Association of Certified and Corporate
Accountants

Questions 3362-3515



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1952

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TERMS OF REFERENCE

(As amended 11th March, 1952)

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages; to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer; to consider the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden fairly among the individual members of the community; to make recommendations bearing in mind that in the present financial situation it may be necessary to maintain the revenue from profits and income; and, in so far as they make recommendations which would on balance entail a substantial loss of revenue, to indicate an order of priority in which such recommendations should be taken into consideration."

NOTE

For the guidance of intending witnesses the Commission published a list of the main heads under which evidence was invited. They explained that the list was not necessarily exhaustive and that witnesses could put in evidence on questions not specifically mentioned, provided that they fell within the Commission's terms of reference. The list is reproduced below.

A. General social and economic questions

1. Is the present system of taxation satisfactory, or could it be improved, in relation to:—
 - (a) incentives,
 - (b) risk bearing,
 - (c) encouraging savings,
 - (d) the control of inflationary or deflationary tendencies,
 - (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment,
 - (f) its effect on the distribution of personal incomes,
 - (g) other economic and social objectives?

These questions can be considered in relation to the taxation of:—

- (i) salaries and wages (P.A.Y.E.),
 - (ii) profits of businesses and self-employments,
 - (iii) dividends and other sources of income.
2. Would it be advantageous to link Income Tax with social security payments and contributions?
3. Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

B. Particular matters

4. Is the taxation not drawn too widely or too narrowly in relation to:—
 - (a) the taxation of United Kingdom residents (companies or individuals) on overseas profits,
 - (b) the taxation of non-residents on United Kingdom profits,
 - (c) the definition of residences, etc.?
5. (a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particular—
 - (b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?
6. Is the basis of computing income from property under Schedules A and B satisfactory?
7. Should the present rules about deductions for outgoings and expenses be altered?
8. Are the provisions for relief in respect of double taxation satisfactory?
9. Should the present system of graduation by means of the exemption limit, personal allowances, reduced rate relief and Surtax be altered?
10. Should the existing differentiation between earned and unearned income be extended or reduced?
11. Are alterations necessary in the rules governing personal and other allowances?
12. Should the rules about the taxation of husband and wife be altered (a) as regards aggregation; (b) in any other respect?
13. Should P.A.Y.E. be altered or abolished?
14. Should the principle of deduction at source be extended or restricted?
15. Should the method of assessment to Surtax be altered, and in particular should it be deducted from salaries?
16. Are any alterations desirable in the systems of administration and the functions of the various statutory bodies or persons connected with taxation?
17. Are any changes in the provisions against avoidance and evasion desirable?
18. Is any alteration necessary in the rules governing the taxation treatment of special classes of taxpayers (e.g., public corporations, co-operative societies, charities)?

THE ROYAL COMMISSION ON THE TAXATION OF PROFITS AND INCOME

THIRTEENTH DAY

Friday, 4th July, 1952

PRESENT:

THE RT. HON. LORD RADCLIFFE, G.B.E. (Chairman)



Mrs. VERA ANSTET, D.Sc.
Mr. H. L. BULLOCK
Mr. W. S. CARRINGTON, F.C.A.
Mr. W. F. CROOK
Sir GEORGE HAYWORTH
Professor J. R. HICKS, F.B.A.
Mr. N. KALDOR

Mr. W. J. KIRKWOOD
Miss L. S. SUTHERLAND, C.B.E.
Mr. J. MILLARD TUCKER, Q.C.
Mr. G. WOODCOCK
Mr. B. R. BROOKES (Secretary)
Mr. D. G. DAYMOND (Assistant Secretary)

Mr. LEO KENNETT and Mr. J. E. HARRIS, on behalf of the Association of Certified and Corporate Accountants; called and examined.

MEMORANDUM SUBMITTED BY THE ASSOCIATION OF CERTIFIED AND CORPORATE ACCOUNTANTS

I. Preamble

1. In what follows the effects of the existing system of the taxation of corporate profits and income on the conduct and nature of business is considered.

2. Consideration is first given to the statutory definition of business income implicit in legislation and its interpretation in the courts, in particular to the effects taxation, based on such definition, has on the replacement of both fixed and floating assets. Consideration is also given to the effect of the incidence of corporate taxation on the availability of capital to industry, of its effect on differing forms of capital and on the balance of the capital structure of businesses. Finally, attention has been directed to the incidence of taxation on corporate bodies and individuals.

3. Reference is made to the actual experience, insofar as it is reflected in company accounts, of a small carefully balanced sample of companies.* The broad general trends which the results of the sample reveal, tend to confirm the complaint of industry that the present system of taxation is adversely affecting its capital resources and is imposing a severe financial strain on business.

4. The figures* largely exclude the temporary effects of re-arrangement. This is important because orthodox accountancy practice tends to exaggerate the profits inflation now emerging in the munitions and related industries and, therefore, masks temporarily the difficulties relating to the financing of replacement, modernisation and extension of fixed assets.

II. Definition of the content of income for purposes of corporate taxation

(a) Period of assessment

5. At present losses can be carried forward and offset against profits earned in the six years following that in which a loss is made: they can be carried back only one year. The choice of twelve months as a basis for measuring profit is a purely arbitrary one. The taxable capacity of a business can only be properly measured by reference to its earnings over its whole life. This principle was recognised for Excess Profits Tax and there would seem to be no logical reason why industry should not be able to offset losses against the profits of the previous six years and against future profits without time limit.

6. The present basis of assessment, under which the accounting profits of a financial period ending within a given fiscal year are deemed to constitute the profits of the succeeding fiscal year, is far from satisfactory. It is, in fact, complicating and misleading. But even more

objectionable are the transitional provisions at the commencement and cessation which cause profits of the opening period to be taxed more than once and the profits of the penultimate year not at all. These arbitrary provisions involve taxation, over the whole life of the business, of a total which only by coincidence corresponds with profits actually earned. There would appear to be no doubt that, despite transitional difficulties, taxation on an "accrual" basis as was the case with E.P.T. and is the case with profits tax, would be more appropriate. It ought to be possible to surmount the transitional difficulties due to the switchover just as a similar problem was overcome in connection with the introduction of P.A.Y.E. Transitional difficulties would clearly be eased if the change could be made in a year when total profits were likely to vary only slightly from those of the preceding year.

(b) The restriction on deductibles allowable as costs or expenses of operation of a business under present practice

7. There exists a significant variation between what logically might be considered as business profit and what is thrown up as "taxable" profit by computations made in accordance with the requirements of the taxing authority. In the course of evidence given before the committee which sat last year under the chairmanship of Mr. J. Millard Tucker, K.C., this particular matter brought more representations than any other.

8. The official attitude on the whole subject of allowable expenses is entirely negative. This arises because the law imposes taxation on business profits without defining them; instead a reverse procedure is adopted of setting out a list of items which are not to be deducted.

9. The restrictive effect of existing legislation largely arises out of the operation and interpretation of Rule 3* and in particular sub-rules (a) and (f) where

"any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession, employment or vocation" and

"any capital withdrawn from, or any sum employed or intended to be employed as capital in such trade, profession or vocation" are disallowed.

10. In exercising its authority, it would appear that the Board of Inland Revenue has acted in particular on these rules as the most tangible guide that it possesses. Differences of opinion have been pursued in the courts and it

* Rule 3 of the Rules applicable to Cases I and II of Schedule D [see I.T.A., 1952, s. 137].

* See Appendix G.

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[Continued]

must be said that the judicial findings—often given *obiter* and usually relating solely to a particular set of facts—have tended to give a narrower interpretation of the law than its actual language would appear to suggest.

11. Thus, in the case of *Strong v. Woodfield*, S.T.C.215, a casual remark that expenses to be deducted "must be made for the purposes of earning profit" has led to the doctrine of remoteness under which many items are disallowed. Similarly, the findings in the *Law Shipping* case, that the very extensive repairs to a ship bought second-hand were to be excluded on the grounds that they were of the nature of capital, has been used indiscriminately to surcharge initial expenditure of all kinds, often of comparatively minor importance.

12. The terms of law, the findings of courts and the zeal of inspectors have combined to place an emphasis on the disallowance of many items of legitimate business expenditure in the assessment of taxable profits. This emphasis is largely accidental and often inappropriate.

13. It is suggested first that taxable income ought to be computed so that any expenditure or disbursement attributable to production or marketing of goods or services is to be regarded as an allowable cost, and second that there is no clear distinction between capital and revenue expenditure. Capital expenditure with certain exceptions is rarely of permanent value; it should more properly be regarded as deferred revenue expenditure which takes longer to pass through the profit and loss account in the form of depreciation, or amortization, or depletion or obsolescence.

(c) Replacement of fixed and floating assets

14. Considerable anxiety has been caused by the combined effects of prolonged inflation and the existing method of taxation on making proper provision for replacement of fixed and floating assets. Fears have been expressed as to the possible effect this may have on the maintenance of the nation's productive capacity.

15. The current accounting method of valuation of fixed assets, that is buildings, plant and equipment, is on a basis of original or historical cost. That of floating assets, stocks, work-in-progress and other current assets, is on the basis of current market valuation or cost, whichever is the lower. Provision for replacement of fixed assets is normally allowed by the taxation authority as an allowance before arriving at gross taxable profit, the so-called depreciation allowances being linked to historical cost. Provision for replacement of stocks of raw materials, semi-processed and finished products is not explicitly recognised as it is assumed that such provision is automatic in the normal operation of company finances through recovery of outlay in direct sale or indirectly by sale of finished products into which the raw materials or semi-finished goods have been incorporated.

16. This technique is, of course, designed to function under conditions of stability of money values. So long as this condition holds, a proper provision for replacement is accumulated and the costs of acquisition of new plant and equipment and stocks for raw materials and semi-finished goods are covered when replacement becomes necessary.

17. Difficulties arise when conditions of inflation or deflation intrude. The problem is quite simple, on a rising market a company buys raw materials and semi-finished goods at $\$x$ and sells them at $\$x + y$, pays profits and income tax on y and finds that it does not possess the resources required to replace them at the new level of $\$x + y$. In the case of fixed assets, businesses are allowed to treat as an expense for purposes of taxation, annual depreciation allowances based on original cost $\$x$. On replacement it is found that the accumulated depreciation provision (ignoring complications of initial allowances and balancing charges) amount to only the original cost $\$x$, the actual cost of replacement being $\$x + w$. The proportion of the replacement cost not so covered, $\$w$, must be met out of net retained profit which is subject to tax. The actual equivalent appropriation from gross profits before tax being much larger therefore than $\$w$.

18. The problem of stock replacement is less indolent for little opportunity is allowed for an accumulated deficiency to occur over time. Generally speaking, once raw materials are utilised, replacement, subject to the exigencies of the raw material markets, is immediate. The difficulties of replacement are none the less real and it can create very considerable financial strain on businesses carrying large stocks when the price inflation is at all large as it was in 1950. As prices rise, stocks must be sold at higher prices or the finished products into which they are incorporated must be costed at the higher level of raw material prices in order to provide for replacement. This involves a nominal monetary profit which is taxed at an effective minimum of more than 50 per cent. The stock replacement fund is thus deficient to this extent. Constant inflation involves the constant drawing into the business of additional working capital or switching from other current assets into stocks in order to finance replacement. Inasmuch as such deficiency in replacement is made good by the raising of new capital, in effect such capital may be regarded as having been raised simply to cover taxation.

19. All this is amply illustrated by the experience of the companies constituting the sample already referred to in the preamble to this memorandum. Whilst book values of fixed assets moved up by about half from 1918 to 1950, values of stock and work-in-progress expanded almost five times. Although undoubtedly a proportion of this is due to an expanded volume of stock carried and of work-in-progress as a result of increased physical production, by far the larger proportion is due simply to the inflation of values.* This large increase in the value of stocks carried has been financed in part by appropriations from profits to reserve and increases in bank overdrafts, short-term loans and other expedients and in part, at least since 1945, by disposing of short-term investments and gilt-edged securities.

20. In many companies profit retention designed to finance fixed asset replacement and modernisation has been absorbed in financing the higher value of stocks. There have even been cases where long-term capital raised with the primary object of acquisition of fixed assets aimed at expansion of productive capacity has been diverted into covering the inflated value of floating assets.

21. It is said that the banks are looking at the current commodity rise with caution and advances to cover the financial requirement created by what might be only temporarily higher raw material values are difficult to obtain. Companies are therefore forced into financing by disposing of liquid assets or by issuing medium term loan capital. Both may involve an unbalance in company finance which might cause serious difficulty in the event of commodity markets collapsing from their present artificially high levels. This situation is typical of what must arise under existing techniques of corporate taxation.

22. The need to meet the costs of replacement out of retained net profits is, in our opinion, evidence that income tax as at present levied is a tax on more than mere income: in fact, we consider that income tax now operates as a tax on both income and capital. Our conception of income is a sum which, at the end of a given period, a business unit could dispose of without impairing the same aggregate of physical assets in the same workable condition as they were at the beginning of the period. It is on income thus defined that tax should be charged. We are not suggesting here a reduction in the total yield from corporate taxation, but submit our view that the position which exists today, where it is not known to what extent true income is being taxed, is wholly wrong.

23. We are fully cognisant of the intricacies that would follow an attempt to alter fundamentally the basis on which income tax is levied, but we nevertheless believe that the difficulties will have to be surmounted if the country's capital—and therefore its future income—is to be protected. As previously mentioned, accounting techniques and income tax practice currently used have been evolved during a period of relative stability in the value of money. But the instability of world affairs during the past decade with the prospect of continuing instability during the forthcoming decades, suggests the probability

* being deficient to the extent of the tax $\frac{xy}{100}$, where x = percentage rate of tax.

† by the extent of the tax $\frac{rw}{100-t}$, where r = percentage rate of tax.

* See figures in Appendix B.

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[Continued]

of a perpetuating instability in the value of money. Moreover, even a period of falling prices would not necessarily compensate for the ill-effects encountered during one of rising prices, as the price fall may be too long delayed, or may be of a different order of magnitude. In this connection it is interesting to note that even in the nineteenth century, Parliament felt it necessary to protect, as far as possible, the real capital of certain statutory companies by requiring a system of Accounting which has become known as the "Double Account System." More recently, Sir Stafford Cripps, when Chancellor of the Exchequer, defended after devaluation an immediate increase in the price of base metals then in stock on the grounds that it was a public duty to protect the Exchequer by treating cost as increasing replacement cost.

24. To protect real capital and to ensure that a part of it is not taxed annually under the guise of income, we consider it necessary to compare income on a basis different from that hitherto adopted and we suggest that the essence of the problem is reached if, as far as practicable, inflows and outflows, represented as receipt and expenditure, are measured in similar units, that is to say units having the same purchasing power. Conscious as we are of the very real practical difficulties of applying this theory in all cases, we suggest that the following proposals would prove to be workable in practice and would at the same time provide for a much more accurate charge against revenue in the assessment of income.

(a) Fixed Assets*

25. That the depreciation allowance be ascertained as hitherto on a historical cost basis, but that the resulting figure be adjusted to allow for the relative change in the price level of the year in question compared to that in which the asset was acquired. Further, the deduction from the cost, to ascertain the carry-forward on which to base the following year's depreciation, should be limited to the allowance computed on the historical cost basis, thus allowing a charge against revenue over the life of the asset, of a sum greater than the original cost of the asset.

(b) Stock

26. That the ordinary *fifo* method of stock valuation inserting into the revenue account a special tax free stock replacement provision equal to the amount of the expansion in stock values due to price inflation be adopted.

III. Existing corporate taxation and the availability of capital to industry

27. The effect of existing corporate taxation on the financial problem of businesses does not end with the financial difficulties of replacement and, of course, is a distinct problem from that of the necessity to measure income accurately. Retained profits normally constitute a source of capital which is used to cover at least part of the cost of modernisation and development. With the intrusion made into net retained profit by taxed provision to cover that part of replacement cost not allowed under existing law, it is extremely doubtful whether this source now fulfils its primary function. If there is some doubt about this, there is certainly no doubt that net retained profits are insufficient to allow, in addition, the building up of adequate financial reserves to cover the unforeseen contingencies of the future. Both these developments are particularly serious, the one because of the need—agreed by government and industry alike—to raise industrial productivity and essential output and the other because of the uncertainties of the current world economic and political situation.

28. It is not the intention in this memorandum to put forward the view that businesses should be self-financing. In order to ensure a balanced and efficient use of resources, it is clearly essential that the availability of capital should in part be determined by the independent assessment of the capital markets, and, in fact, industrial capital is normally available from sources both within and outside the individual firm.

29. Nevertheless, the fact is slowly emerging that sources of capital external to the firm are gradually drying up.

This is the result of a long term trend deriving principally from the tendency for taxation of personal incomes to become more steeply progressive. While this may be justified on various other grounds it is a fact of serious consequence for business. It is not a phenomenon confined to Britain alone, but is characteristic, to a greater or lesser degree of other countries following a similar economic and social development.

30. However, in our view it is a particularly serious phenomenon for this country if it wishes to enjoy the standard of living so far maintained. Whereas in the 19th and early 20th centuries the U.K. firmly held a predominant position in the markets of the world, as a result of two wars and a rapidly changing situation, this is no longer the case. We are now faced, amongst many others, with two giant competitors, the U.S.A. and the U.S.S.R., which are rapidly increasing their capital potential.

31. Hence it appears to us essential, for the welfare of this country, that it should be in a position to seize the initiative in new industries. If it cannot compete successfully in lines where there is a premium on very large scale production, then it must make its effort along other channels, in new spheres, where it can establish a lead in novel or highly specialised processes which do not admit of mass production. But to do this, capital must be available to move freely and a high premium must be placed on the mobility of capital and of other resources. Thus our taxation policy should be developed to prevent the outlying process which now appears so prevalent.

32. Figures* of new capital issues show that, whereas non-government issues averaged £145 million in 1948 and 1949, in the five years ending 1957 the figure was £163 million, in the five years ending 1950 £284 million and immediately prior to 1914 probably over £200 million. The extent of the fall is much greater than the figures reveal for the true position is masked by the depreciation in the value of the currency. Expressed as a proportion of the national income, new issues fell from the high level of nearly 10 per cent. in the pre-1914 era, to 7 per cent. in the twenties, to 4 per cent. in the thirties, and to less than 1½ per cent. in 1948-49.

33. The contraction in the supply of capital to industry through the new issue market has of course been accentuated by taxation policy during the war period and its aftermath. Net personal savings, after allowing for taxes on capital, have steadily declined over the post-war years, and in 1949 they were only £174 million compared with £658 million in 1946 and an estimated £139 million in 1934† when the value of the currency stood much higher. The pre-war figure, in fact, represents some £256 million in terms of 1949 purchasing power.

34. Securing a reversal in the trend is likely to be a long and difficult process. In any case there is a degree of permanence in the situation, due to fundamental changes in the economic and social structure largely connected with the redistribution of income, which precludes the eventual adequacy of supplies from this source. Industry is increasingly dependent therefore on the aggregate of retained profits as a source of capital for the financing of new development.

This source can be expanded in only three ways:—

- by a policy of dividend reduction,
- by expanding gross profit through raising product prices in order to recover taxation, or
- by modifying the level or incidence of corporate taxation insofar as it affects retained profits.

35. The first can be dismissed summarily having regard to its probable effect on the supply of capital from external sources i.e. through the new issue market or the large institutional investor. The second is to be deprecated on the grounds of its inflationary effect alone. Taxation, in fact, is fast coming to be considered as a charge which can be legitimately passed on to the consumer. To this extent, therefore, the second method of safeguarding reserves already operates. The only practical possibility seems to be the modification of the incidence of corporate taxation on undistributed profits thus recovering revenue from another direction. The other two suggestions in fact provide no solution at all.

* Compiled by the Midland Bank and quoted by Professor Patten in an inaugural lecture given at the University of London in December, 1950.

† Cmd. 7933.

* See Appendix A.

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[Continued]

36. There would seem to be, however, no *prima facie* reason why undistributed profits should not be subject to income tax at the standard rate in the same way as capital coming from outside the business, which is derived from incomes already taxed at that rate plus or minus adjustments depending on the individual circumstances of the investor. Equally the view is taken that differential treatment in the way of additional statutory taxation on undistributed profits at 50 per cent. less a relief of 40 per cent., giving an effective rate of 10 per cent., constitutes an unsatisfactory drag on the financing of business.

37. The burden of profits tax on undistributed profits, however, is far more severe than at first appears for, in point of fact, the whole of the profits tax on gross profits whether distributed or retained falls on the undistributed portion. Profits tax on gross dividend is not deducted as is income tax. This point is illustrated by a computation set out in Appendices C and D.

38. Owing to the peculiar incidence of profits tax, the effective rate of actual taxation on distributed profits remains constant at 47½ per cent. of the gross dividend irrespective of the proportion distributed. The burden of profits tax falls in entirety on retained profits which are effectively taxed at rates varying between 52½ per cent. and 100 per cent. of the gross figure. The effective rate of taxation on retained profits increases as the proportion distributed increases. In fact, profits tax on both distributed and undistributed profits may be regarded effectively as a graduated tax on retained profit which varies inversely to the proportion of such profit retained. In the case of equal allocation of gross profits between dividends, and reserves and carry forward—as is the practice followed by a large number of companies—the effective rate of tax on total profits is 63½ per cent. with the effective rate on undistributed profits—even in this normal case—as high as 79 per cent. or 15s. 9½d. in the £.

39. It is a point of interest that the mechanics of operation of profits tax restricts the total distribution of profits to 64½ per cent. of gross earnings. This is so because the 35½ per cent. remainder is completely absorbed by profits tax. In the other extreme case where no dividend is declared and gross profits are put entirely to reserve for ploughing back into the business, the effective rate of taxation on the profit retained still amounts to over 50 per cent. or more than 10s. in the £ on gross earnings. A company must earn, therefore, at least £20,000 gross before it can provide a net addition of £10,000 to reserves even though it makes no distribution. The required earnings figure before the war would have been about £13,333. This is a measure of the increased drain on industry's internal capital resources resulting from the incidence and level of post-war taxation.

40. Reference to Appendix E, in which is summarised the actual experience of a large sample* of companies publishing reports during 1950, shows that income and profits tax combined absorbed 52 per cent. of gross taxable profits.

41. The comparative experience of industry pre-war and post-war is illustrated in the results of the small sample† also set out in Appendix E. A considerably higher proportion of gross profits is absorbed by taxation in the case of identical companies in 1950 compared with 1938.

42. Reference to the actual figures in Appendices F and G shows that whereas gross profits increased by £35 million, dividends only moved up £1·4 million. Although dividend limitation is no doubt responsible in part for this very small increase, perusal of the figures shows that dividends were actually lower in 1945 than in 1938. These was adequate scope for expansion in distributed profits in 1946 and 1947 prior to the introduction of dividend limitation. The fact that there was no such expansion suggests that there were, and probably still are, pressures other than the dividend limitation agreement keeping down dividends. The bulk of the expansion in gross profits was, in fact, absorbed by increased taxation to the extent of £19·5 million and increased appropriation to reserves (and carry forward) to the extent of £15·4 million. The additional reserve appropriations were ploughed straight back in to the business as a result of the pressure for finance. Cash and other liquid assets in the companies constituting the sample were actually lower in 1950 than in 1945. The provision of capital by appropriations of

profit to reserve has been clearly inadequate despite new issues of both loan and share capital, for there has been a considerable increase in financing by means of short-term bank loan and overdraft during the intervening period.

43. This financial strain on company reserves is very largely the result of the operation of profits tax which depleted the capital resources of all companies by £23 million* in the fiscal year ending in 1951.

44. We are of the opinion that it is not necessary to suggest alternative means of raising taxation as we believe that a stimulus to the mobility of capital would in itself ultimately ensure the maintenance of revenue which is now deemed necessary. We are of the opinion that by putting a premium instead of a discount on profits, the country's capital will once again flow freely into activities where the return on capital is greatest, thus increasing the national income, which would in turn facilitate the raising of revenue to balance a national budget of present dimensions.

IV. Existing corporate taxation risk bearing and the capital structure of industry.

45. The existing system of corporate taxation both in relation to the level of tax and its incidence is having considerable adverse effect on risk assumption and on the balance of the capital structure of business.

46. Although income tax falls on both preference and ordinary share capital by deduction at source, and on debenture and loan capital by deduction on receipt, profits tax falls entirely on the risk-bearing portion of industry's capital. Ordinary shareholders, like preference shareholders, do not actually pay profits tax out of dividends but their reversionary interest in the company is affected. This is so partly because profits tax reduces the retained profit available for ploughing back into the business thus affecting future earnings capacity, and partly because it cuts down the maximum dividend which can be paid out giving the necessity of a minimum prior ploughing-back of profits into the business. Both these factors affect the break-up values of companies and their market valuation on the Stock Exchange.

47. Quite clearly, therefore, both capital values and current yields are adversely affected to the detriment of the willingness of investors to assume the differential risk involved in investing in companies through the medium of ordinary share capital.

48. Within companies, the general level of taxation and in particular the incidence of profits tax tends to relax normal restraint on inefficiency and extravagant expenditure and tends to lead to an aversion on the part of boards of directors to take normal risks, to say nothing of the incentive it gives to doubtful practices designed at tax avoidance or even evasion. All this tends to react unsatisfactorily on the efficiency and earning power of business and therefore once again on the willingness of investors to support the market for new ordinary share capital.

49. It has, in fact, two serious consequences. The one consists of causing risk capital to be switched abroad where lower or more equitably designed taxation secures a higher return on investment. In extreme cases, it has actually led to the migration and re-registration of companies overseas. This development has reached some proportion in the exodus of mining companies whose field of operations is abroad. Private investors in such companies quit in the appreciation of their reversionary interest in the companies but this is cancelled out in part, in the case of institutional investors, by their liability for profits tax on dividends so received.

50. Even more important is the general trend of emigration of companies situated in this country which operate abroad. London is no longer of its former importance as a centre of companies controlling a large part of the world's raw materials, as a result of which the British manufacturer has lost the ready access to these raw materials to which he was formerly accustomed. The transfer of location of the financial centre of such companies to foreign lands, often accompanied by a transfer of the commodity market exchange, has reduced this country's ability to obtain these primary materials at which it is particularly dependent and without which it could not survive as a great power.

* The Economist, January 27th, 1951.

† Appendices F and G.

* Financial Statement, 1951-52, H.M.S.O.

† In the absence of dividend limitation.

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[Continued]

51. The other consequence consists in the encouragement, which the burden of corporate taxation and the incidence in particular of profits tax gives to companies, to switch from preference and ordinary share capital to debentures and other forms of loan capital. Such capital bears no profits tax and creates no additional charge for the company in the way of liability to income tax, the interest on such capital constituting, as it does, a prior charge to be deducted before arriving at a figure of gross taxable profit. The growing move towards this form of financing is amply illustrated by the trend in the proportion of new issues by companies* consisting of loan capital, which rose from 11 per cent. in 1948 to 50 per cent. in 1949 and to 55 per cent. last year† when there was a boom in such issues particularly of medium term unsecured notes.

52. Excessive financing by means of loan capital, although relieving the industry of additional taxation and easing the capital resources problem, tends to lead to an unsatisfactory balance of the capital structure. The authorities introduced its most burdensome in companies where prior ranking preference capital forms a large proportion of total issued share capital. It could be particularly serious in the event of a general depression in which profits contract. If pressed to any substantial degree it might well involve under such conditions a wave of financial embarrassment of companies which could be quite serious to the stability and eventual rate of recovery of the economy.

53. We wish to stress that we contemplate continuance of the present level of revenue on the assumption of an increased buoyancy of the National Income (as a result of factors we have outlined). Should such an assumption not be vindicated very serious consideration should be given to the following:

- (a) to the priority of securing proper replacement and development of essential industrial capacity, and
- (b) to ensure the availability of risk capital to finance new industries (which taxation of profits inhibits), as against that of maintaining the marginal outlay in other directions.

V. The Incidence of Taxation on Corporate Bodies and Individuals.

54. The taxation of companies differs from that of other trading units in the following respects:

Income Tax:

All profits are taxed at the standard rate; no deductions being made for earned income or other "personal" allowances being made. In the case of private companies the result is, frequently, to pay larger salaries to directors, etc., than would otherwise be regarded as advisable; although this does not necessarily prevent the ploughing-back of profits as additional capital, it is probable that the practice does operate to reduce the amounts dealt with in this way. (In theory, the reverse might be the case, since the saving of tax would itself provide additional resources for this purpose.)

* *Midland Bank Review*, February, 1951.

† The results of the small sample of companies set out in Appendix F show an equal proportion of expenditure in ordinary and debenture capital which considerably understates the position. This arises because

- (a) the sample being small tends to omit its six net certain large debenture issues, and also because
- (b) the boom in this class of issue tended to be concentrated towards the end of the year when many of the 1949-50 accounts of companies constituting the sample were closed.

Profits Tax:

This is charged only on incorporated bodies. In so far as its scheme is devised to discourage the distribution of profits, it does, no doubt, have some degree of success in tending to limit such distribution. While, in the majority of cases, this may be a desirable consequence, it is not invariably or necessarily so.

The main criticism of the tax is that it discriminates against one particular type of income and, in particular, that this discrimination results in the entire burden falling upon the persons contributing the "risk capital," i.e., the equity shareholders. There is great difficulty in discovering any logical, moral or other justification for this state of affairs and its economic consequences in discouraging the risking of such capital the possible profit from such investment being (according to the weight of the duty) disproportionate to the risks involved.

Furthermore one particular aspect of the Profits Tax Act, namely provisions relating to distribution charges† has damaging effects on corporate bodies in the years when they can least afford it.

All such taxes may have, and no doubt have had, the following consequences:

- (i) The encouragement of extravagance; that is one facet of the wider consequence of the discouragement of incentive. If only an insignificant net benefit is likely to result from economy in administration, etc., there is obviously less incentive to make serious effort to effect such economies.
- (ii) The general reluctance to take risks, and to be enterprising.
- (iii) The encouragement given to activities which appear to offer better chances of financial reward merely because they are sufficiently "unorthodox" as to fall outside the scope of the taxes—e.g., of the type commonly known as "faddism". There is, in addition, a tendency to consider all actions in the light of the consequences from a taxation point of view, so that action taken, while no doubt legitimate and not necessarily harmful, is other than what would have been regarded as most desirable if such consequences had not been taken into account.
- 55. We consider it just that private companies should be allowed earned income relief on retained net profits which relief could be based upon a maximum figure of say £1,000 per director, and further subject to an overriding maximum of, say, £4,000.
- 56. In computing profits tax liability, dividends on preference* shares should be allowed as a deduction from profits and should not therefore be included in the computation of distributed profits.
- 57. The reason for such recommendation is that we do not think it logical to distinguish between loan capital, namely bank overdrafts, notes and debentures which bear a fixed rate of interest and preference capital, and also bears a fixed rate of return. The main argument being that none of these bears the risk borne by the equity.

11.5.1951.

† See Appendix H.

* Preference shares to include all forms of preference shares, including participating preference, although it is submitted that in this connection a dividend be allowed as a deduction which is to be restricted to that payable without further participation in profits.

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[Continued]

APPENDIX A
INDEX OF FIXED ASSETS REPLACEMENT COSTS
Average Cost of Replacement

Assets originally bought in year	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947	1948	1949	1950
1938	100	102	114	134	145	150	156	166	184	207	220	232	240
1939	—	100	112	131	142	147	153	163	180	205	216	227	236
1940	—	—	100	118	127	132	137	146	161	182	193	204	213
1941	—	—	—	100	108	112	116	124	137	154	164	173	181
1942	—	—	—	—	100	103	108	114	127	143	152	160	166
1943	—	—	—	—	—	100	104	111	123	138	147	155	162
1944	—	—	—	—	—	—	100	106	118	133	141	149	156
1945	—	—	—	—	—	—	—	100	111	125	133	140	146
1946	—	—	—	—	—	—	—	—	100	113	120	126	132
1947	—	—	—	—	—	—	—	—	—	100	106	112	117
1948	—	—	—	—	—	—	—	—	—	—	100	105	110
1949	—	—	—	—	—	—	—	—	—	—	—	100	106
1950	—	—	—	—	—	—	—	—	—	—	—	—	100

APPENDIX B
INDEX OF COSTS OF STOCKS OF RAW MATERIALS, FINISHED GOODS AND WORK IN PROGRESS

	Index based on 1938 = 100			Annual Percentage Change		
	Raw Materials	Work in Progress	Finished Products	Raw Materials	Work in Progress	Finished Products
1938	100	100	100	—	—	—
1939	107	102	99	+7	+2	-1
1940	129	119	119	+20	+36	+20
1941	179	158	132	+39	+14	+11
1942	182	162	136	+3	+3	+3
1943	187	164	138	+3	+1	+1
1944	198	168	141	+6	+2	+2
1945	202	173	144	+2	+3	+2
1946	206	187	155	+2	+8	+8
1947	246	214	168	+19	+14	+8
1948	322	238	189	+31	+11	+13
1949	320	249	194	+1	+5	+5
1950	429	282	220	+34	+13	+6

Based on Board of Trade wholesale price indices of basic materials, intermediate products and manufactured articles.

APPENDIX C (Revised)
INCIDENCE OF CORPORATE TAXATION AS BETWEEN DISTRIBUTED AND UNDISTRIBUTED PROFITS (a) (b)

	Case A Complete Retention			Case B Complete Distribution			Case C Equal Distribution/Retention		
	Distributed	Retained	Total	Distributed	Retained	Total	Distributed	Retained	Total
Distribution of gross profit	nil	10,000	10,000	6,429	3,571	10,000	5,000	5,000	10,000
Profits tax	nil	1,000	1,000	3,214	357	3,571	2,500	500	3,000
Profits tax transferred		5,000	9,000		3,214	6,429		4,500	7,000
Profit subject to income tax		5,000	9,000		—3,214	—		—2,500	—
Income tax	nil	4,275	4,275	6,429	nil	6,429	5,000	2,000	7,000
Net dividend	nil			3,054	nil	3,054	2,375	950	3,325
Net retained profit				3,375			2,625		
Net distributed and retained profit		4,725	4,725		nil			1,050	5,675
Total tax	nil	5,275	5,275	3,054	3,571	6,625	2,375	3,550	5,925
Total net profit distributed and retained	nil	4,725	4,725	3,375	3,571	6,946	2,625	1,050	3,675
Effective tax rates (a) in the £	nil	10s. 6½d.	10s. 6½d.	8s. 6d.	20s. 100-0	13s. 3d.	9s. 6d.	15s. 9½d.	12s. 7½d.
(b) per cent.	nil	52-75	52-75	47-50	100-0	66-25	47-50	79-00	63-25

(a) Based on new rates of (1) Income Tax at 5s. 6d. in the £.

(2) Profits Tax at 50 per cent. on distributed profits.

(b) Showing the allocation of each £10,000 of profits gross, above the minimum of £12,000.

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[Continued]

APPENDIX D

EFFECTIVE TAXATION(a) RATES OVER A FULL RANGE OF DISTRIBUTION AND RETENTION OF PROFITS(d)

Allocation of each £10,000 of gross profit(c)		Effective rate of taxation on per cent. in		
Distributed	Retained	Distributed	Retained	Total Profit
£ n(b)	£ 10,000	Per cent.	Per cent.	Per cent.
500	9,500	47.5	52.5	52.5
1,000	9,000	47.5	54.1	53.8
1,500	8,500	47.5	55.7	54.9
2,000	8,000	47.5	57.4	55.9
2,500	7,500	47.5	59.5	57.0
3,000	7,000	47.5	61.5	58.0
3,500	6,500	47.5	64.0	59.1
4,000	6,000	47.5	65.9	60.2
4,500	5,500	47.5	70.3	61.2
5,000	5,000	47.5	74.2	62.3
5,500	4,500	47.5	79.0	63.3
6,000	4,000	47.5	84.8	64.3
6,429(c)	3,571	47.5	92.1	65.4
			100.0	66.5

(a) Profits tax and income tax.
 (b) Minimum dividend.
 (c) Maximum dividend.

(d) At the 1951 budget rates.
 (e) Above minimum of £12,000.

APPENDIX E

BREAKDOWN OF GROSS PROFITS PREWAR AND POSTWAR

	Percentage Breakdown		
	Small Sample(a) 1938	Small Sample(a) 1950	Large Sample(b) 1950
	Per cent. 100 30(c) 70	Per cent. 100 49(d) 52	Per cent. 100 52 48
Gross profits (before taxation)	100	100	100
Total tax	30(c)	49(d)	52
Net profit (after taxation)	70	52	48
Profit to minority interests	2	2	1
Not dividend	45	16	17
Not retention	23	34	30

(a) Balanced sample 24 companies.
 (b) Straight sample 2,388 companies: see *The Economist*, January 27th, 1951.
 (c) Slightly high, probably owing to overprovision amongst companies constituting sample in 1938.
 (d) Low, owing to rebates and crediting of overprovisions made in previous year.

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[Continued]

APPENDIX F
BALANCE SHEET ANALYSIS OF SMALL SAMPLE OF COMPANIES

	Sample aggregate in £ million(s)			Percentage distribution		
	1938	1945	1950	1938	1945	1950
CAPITAL EMPLOYED: LIABILITIES						
1. <i>Current liabilities and provisions</i>				Per cent.	Per cent.	Per cent.
(a) Short term loans and bank overdrafts	1.5	3.3	12.1	1	1	3
(b) Accrued charges and creditors(a)	32.4	64.3	63.0	15	22	14
(c) Provision for taxation			40.6			9
(d) Other specific liabilities(b)		22.1	34.5		7	7
(e) Total	33.9	89.7	150.3	16	30	33
2. <i>Minority interest in subsidiaries</i>	12.6	13.0	18.0	6	4	4
3. <i>Debentures and long term loans</i>	34.9	22.2	27.0	11	8	6
4. <i>Share capital</i>						
(a) Preference	35.4	38.2	39.5	17	13	8
(b) Ordinary	80.1	84.4	104.0	37	28	23
(c) Total	115.5	122.6	143.5	54	41	31
5. <i>Reserves</i>						
(a) Capital (including share premiums and EFT refunds)	3.2	3.8	35.8	1	1	8
(b) Revenue (including carry forward)	26.2	47.2	82.6	12	16	18
(c) Total	29.4	51.0	118.4	13	17	26
6. <i>Total liabilities</i>	217.3	296.4	457.3	100	100	100
EMPLOYMENT OF CAPITAL: ASSETS						
1. <i>Current assets</i>						
(a) Stocks and work in progress	37.6	77.6	144.8	17	26	32
(b) Payments in advance and debtors	27.7	52.6	85.1	13	18	19
(c) Short term investments and marketable securities	6.3	2.1	0.9	3	1	—
(d) Gift-edged	1.1	13.9	2.4	—	4	—
(e) Cash	7.6	26.3	32.8	4	9	7
(f) Total	80.2	172.5	366.0	37	58	58
2. <i>Fixed assets</i>	103.7	91.9	149.6	48	31	33
3. <i>Intangibles (including goodwill, patents, etc.)</i>	22.7	20.2	20.3	10	7	4
4. <i>Trade investments and interests not consolidated</i>	10.6	15.8	21.3	5	4	5
5. <i>Total assets</i>	217.3	296.4	457.3	100	100	100
DERIVED FIGURES						
1. <i>Net current assets</i>	46.3	82.8	115.8	...	...	...
2. <i>Net assets</i>	183.4	208.7	307.0	...	...	...
3. <i>Net tangible assets</i>	160.7	188.5	286.7	...	...	...
4. <i>Reserves less tangibles</i>	6.6	30.7	98.1	...	...	...
5. <i>Original cost of fixed assets(c)</i>	...	...	288.7	...	...	...
6. <i>Accumulated depreciation provision</i>	...	...	139.1	...	...	...

(a) Including deferred liability arising out of initial slowmovers.

(c) Or as revealed under the 1948 Companies Act.

(b) Including provisions for deferred capital.

(d) Figures may not add up exactly, owing to rounding.

NOTE ON THE SAMPLE: The figures are derived from a carefully balanced, though very small, sample of 24 public companies, representing a broad cross-section of industry varying in size from the very large to the very small. Every consideration has been given to the elimination of bias. The constituent companies have also been selected so as to avoid, as far as possible, factors of non-comparability entering into the result, although minor errors may arise through this as through normal sampling error. The separate-company figures on which the aggregate is based normally refer to accounting periods ending within the year stated.

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[Continued]

APPENDIX G
PROFIT ANALYSIS OF SMALL SAMPLE OF COMPANIES

	Sample aggregate in £ million(b)			Index 1938 = 1.0		
	1938	1945	1950	1938	1945	1950
1. Trading account balance	20.6	35.5	67.2	1.0	1.7	3.3
2. Non-trading income						
(a) From investment	0.3	0.3	0.9	1.0	1.0	2.6
(b) Other sources	1.1	1.2	1.7	1.0	1.0	1.5
(c) Non-rotating	0.1	1.0	2.0	1.0	7.8	16.3
	1.5	2.5	4.6	1.0	1.7	3.1
3. Total income	22.2	37.9	71.7	1.0	1.7	3.2
4. Directors' emoluments, administration charges, etc.	0.9	2.9	5.2	1.0	3.2	5.8
5. Repairs and maintenance	0.6	0.5	0.6	1.0	1.4	1.8
6. Depreciation	4.3	7.4	16.2	1.0	1.7	3.3
7. Debenture and other loan interest	1.0	1.1	1.2	1.0	1.1	1.2
	6.6	11.9	21.2	1.0	1.8	3.2
8. Gross profit, before tax	15.6	26.1	50.6	1.0	1.7	3.2
9. Taxation						
(a) Profits tax (or N.D.C.)	4.8	12.0	23.4	1.0	2.5	4.9
(b) Income tax	—	2.7	—	—	—	—
(c) E.P.T.	—	—	0.8	—	—	—
(d) Other taxation(e)	—	—	—	—	—	—
(e) Total	4.8	14.7	24.2	1.0	3.1	5.0
10. Net profit, after tax	10.9	11.4	26.4	1.0	1.1	2.4
11. Profit to minority interests in subsidiaries	0.3	0.5	1.0	1.0	1.7	3.3
12. Net group profit, after tax	10.6	10.9	25.4	1.0	1.0	2.4
13. Dividend, after tax						
(a) Preference	2.0	1.4	1.6	1.0	0.7	0.8
(b) Ordinary	5.0	4.2	5.8	1.0	0.8	1.4
(c) Total	7.0	5.6	8.4	1.0	0.8	1.2
14. Appropriations for						
(a) Deferred income tax liability and future provision	—	—	2.6	—	—	—
(b) Additional depreciation requirement	0.1	1.7	3.2	—	—	—
(c) Other provisions	0.5	1.2	1.1	1.0	2.3	2.0
(d) Capital reserves	—	—	4.0	—	—	—
(e) Revenue reserves (and carry forward)	2.5	1.8	4.7	1.0	0.7	3.5
(f) Total	3.1	4.7	15.5	1.0	1.5	5.0
15. Retained as reserves in subsidiaries	0.5	0.6	1.5	1.0	1.1	2.9
	10.6	10.9	25.4	1.0	1.0	2.4

(a) Including overseas taxation, and adjustments due to over or under provision in previous years.

(b) Figures may not add up exactly owing to rounding.

NOTE ON THE SAMPLE: The figures are derived from a carefully balanced, though very small, sample of 24 public companies, representing a broad cross-section of industry varying in size from the very large to the very small. Every consideration has been given to the elimination of bias. The constituent companies have also been selected so as to avoid, as far as possible, factors of non-representativeness entering into the result, although minor errors may arise through this as through normal sampling error. The separate-company figures on which the aggregate is based normally refer to accounting periods ending within the year stated.

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APPENDIX H

YEAR 1 (GOOD YEAR)		YEAR 2 (MEDIUM YEAR)	
	£		£
Profits	3,000	Profits	300
Controlling Directors	3,500	Controlling Directors	3,500
Dividend	500	Dividend	500
	7,000		4,300
Less Statutory remuneration	2,500	Less Statutory remuneration	2,500
	4,500		1,750
Less abatement	1,500		
	3,000		
N.R.D. 3,000 x 4,000-2,500 4,500	1,000	When abatement applied, no liability to Profits Tax.	
Charge to Tax: £3000 @ 30 per cent.	900	Distribution Charge:	
Less Non-Distribution Relief £2,000 @ 20 per cent.	400	Distribution	4,000
		Less Statutory remuneration	2,500
			1,500
Tax payable	500	Exceeded by Profits	1,750
		Therefore no Distribution Charge.	
YEAR 3 (POOR YEAR)		When abatement applied, no liability for year but liability arises re Distribution as below:	
	£		£
Controlling Directors	3,500	Distribution	4,000
Dividend	500	Allowable	2,500
	4,000		
Less loss	600		1,500
	3,400	Profit (from previous column)	500
Less Statutory remuneration	2,500		
	900	Tax payable by way of Distribution Charge @ 20 per cent. = £120	

EXAMINATION OF WITNESSES

3362. *Chairman:* Mr. Kennett and Mr. Harris, I am glad to see you and I thank you for your interesting memorandum. Which of you is going to do the burden of the answering, or are you both going to do it?—Mr. Kennett: We shall both be answering.

3363. There are one or two questions I would like to go through with you. In Part II you are dealing with the definition of the content of income for purposes of corporate taxation, and you point out in paragraph 5, with regard to the period of assessment, "The choice of twelve months as a basis for measuring profit is a purely arbitrary one. The taxable capacity of a business can only be properly measured by reference to its earnings over its whole life." Is that a really practicable basis on which to approach the problem of taxing companies?—Our approach to this is this, Sir: that we think the desirable aim should be that accounts should be prepared equally for all purposes for which they are needed. In other words, that accounts prepared for proprietors should be identical, or as nearly as possible identical, to the accounts which are submitted to the Inland Revenue, and that would imply that they also, as far as possible, should be contemporaneous.

3364. I quite follow it would be a very satisfactory thing if the company's accounts, for the purposes of publication to its shareholders and otherwise, were on the same basis as those used for taxation. That is what you are suggesting, is it? But here you are making the point that you really cannot measure the taxable capacity of a business unless you know its earnings over its whole life. I was wondering if that could be a practical basis to approach this matter on.—It is an arbitrary decision to divide the life of a company into years. The real earning power must be judged over a much longer period. It is quite arbitrary to say profits are made this year or the next year. That is what we meant by saying this.

3365. But what would you do to implement that because the budget has got to go on, has it not?—In this report all we mean to say is that we think it would be most desirable if ways and means could be found whereby the account submitted to the Inland Revenue would be for the same year as the accounts submitted to the

proprietors. Our memorandum had been prepared before the Tucker Committee's Report* was published and the Tucker Committee has dealt with this problem fairly exhaustively. We did not know the findings at the time. I know there are various technical difficulties, not on the side of the accountant but more on the side of the Inland Revenue.

3366. One of the practical results would be, of course, carrying back losses against previous years, would it not?—Partly, yes.

3367. Another one would be carrying losses forward against as many years as you could be allowed?—Carrying them forward and to some extent carrying backward.

3368. Yes. "To some extent" means you cannot go back too many years?—Yes.

3369. I just want to turn for a moment, I think I follow it, to your rather important statement in paragraph 13 about the way to compute taxable income (you have emphasised it). "It is suggested first that taxable income ought to be computed so that any expenditure or disbursement attributable to production or marketing of goods or services is to be regarded as an allowable cost, and second that there is no clear distinction between capital and revenue expenditure. Capital expenditure with certain exceptions is rarely of permanent value; it should more properly be regarded as deferred revenue expenditure which takes longer to pass through the profit and loss account in the form of depreciation, or amortization, or depletion or obsolescence." That really means, does it, that with the exception of a few forms of expenditure such as that on land, let us say, in some form all expenditure should, in your view, be passing through the profit and loss account?—Yes. All expenditure which must in the end be recovered from the operations of the business. Now we would classify expenditure into two groups. One group we would call revenue expenditure and we would expect revenue expenditure to be recovered in the year in which it has been made. We would group other sorts of expenditure as capital expenditure or deferred revenue expenditure and we would

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expect out of the operation of the business to recover the cost over a number of years, a given number of years.

3370. Does that mean that what you would recover over that number of years is the sum of money that you spent in the first instance?—If I may put it like this, Sir, I would say we should recover not less than the sum of money actually spent.

3371. Yes, I see. But I just want to get at the basis of it. It is the cost that you spend that you are considering, is it, and deferring it over the number of years of life of the asset?—Yes, disregarding entirely the implication of inflation and the fluctuating value of money, the amount that has been spent on an asset which we classify as capital asset, should be recovered from revenue over a stated number of years.

3372. Yes?—And this sort of expenditure which we classify as revenue expenditure should be recovered in the year in which it has been made.

3373. But would the fact that there might have been inflation over the period of years you are considering, affect the basic theory that you are trying to recover your costs?—Yes. But this is a second consideration. The first consideration is that we think that the differentiation between capital and revenue expenditure is merely a convention which requires a certain expenditure to be recovered in one year, and another kind of expenditure not to be recovered in this year but in many years.

3374. Yes. If that is the theory, I just want to get your view why it is affected by the fact that there has been a decrease in the purchasing power of the £ over the period of years during which the recovery takes place.—Well, if I may say this: the aim should be to arrive at a correct assessment of profits, for profits for a business are identical with income. Income is the outflow of expenditure and the inflow of revenue, but as far as possible the outflow and inflows should be of the same value of money. If I may put an example, if you have a machine on which you spend through the year £X for maintenance, that is money spent in the current year, but then you have to provide £Y for depreciation and these £Y should be in exactly the same, or as nearly the same value of money as money spent on maintenance. We classified maintenance expenditure as a revenue expenditure; we therefore take it in the year in which we spend it; the normal wear and tear of the machine is classified as capital expenditure. But in order to arrive at a proper accounting of income and profit, we should allow the same money value for this type of expenditure as we allow for the revenue expenditure.

3375. The result would be in a period of inflation you would recover more than your cost, would you not?—Yes.

3376. I appreciate that is the argument. But would you say that is recognized as a principle of accountancy today, to recover more than your costs because of inflation?—I would venture to say that when the Tucker Committee was sitting and preparing its report, I think the opinion was that those in the profession who advocated that reform of accountancy principles should take account of the changing value of money were most certainly the minority. But in the meantime opinion has very considerably switched in the profession, and the recent International Congress has shown that, not only in this country but also abroad, opinion has definitely switched towards the recognition of the changing value of money in accounts. On the other hand, it is certainly of benefit to ventilate the problem because we would abandon a firm system which we have now, which is closed in itself, and those who do not yet see their way to accept the reforms do so not because they do not admit the necessity or the desirability of reform, but because they do not see yet the safeguards which must be, which ought to be, built into the new system in order to make the system again a closed one which is as far as possible exempt from arbitrary interpretation.

3377. Yes. I know there were some valuable papers read at the Congress you were referring to. Did they result in any resolutions passed at the Congress or anything like that?—No, no such resolutions were passed at the Congress. If I may say this, it means a departure from accounting principles which were as far as we can judge excellent in their concept and very efficient in their

application for a number of years. But they were conceived at a time when the value of money was beyond argument. Nobody thought that the value of money would change and the whole system of accounting conceptions was based on the assumption that the value of money remained static. Now this assumption, I think, cannot be taken for granted, could not be taken for granted for the last 30 years, and it seems doubtful whether it can be taken for granted for the future.

3378. Thank you. Just help me again in paragraph 22, would you, because these definitions, I think, are very important. You are saying, "Our conception of income is a sum which, at the end of a given period, a business unit could dispose of..." That, I suppose, means "could detach from the business"?—Yes.

3379. "... without impairing the same aggregate of physical assets in the same workable condition as they were at the beginning of the period." I am not quite clear how that definition takes account of the undoubted fact that your business, your physical assets, must get impaired. That is what depreciation is directed to?—Yes. That means that we must provide out of current revenue sums which equalise these depreciations of the physical conditions of assets.

3380. It means then that you must retain in the business enough money to take care of the deterioration of the physical assets that must take place?—Yes, so that at the end of the year we could say that the earning capacity or the physical assets of this enterprise are in the same condition, or not worse, than they were at the beginning, and for whatever deterioration has occurred during that year we have provided sufficient reserve, sufficient depreciation allowance before we calculate the profits.

3381. Yes, that really means, does it not, that you must include in your physical assets, as you call them, the money fund that you are creating to make good the assets that are depreciating?—Yes.

3382. Then you go on to the problem of fixed assets, and your suggestion in paragraph 25 is, "That the depreciation allowance be ascertained as hitherto on a historical cost basis, but that the resulting figure be adjusted to allow for the relative change in the price level of the year in question compared to that in which the asset was acquired." I want to draw on your experience here. Would there not be very great practical difficulties in being able to perform a calculation of that kind for businesses?—I think it certainly would create some clerical work. It should not create difficulties in companies where the accounts are kept on modern principles. In other words, where the price of every asset is categorised and recorded, that could easily be ascertained. Of course, there will be cases where this is not so easily possible. But I think the application of the principle should not be jettisoned because it may create, at least for the beginning, certain technical difficulties.

3383. I want to get from your experience the measure of what the difficulty would be, because we must think of all kinds of businesses, must we not?—Small businesses which have not elaborate records, as well as big businesses and businesses which have detailed records?—Would there not be a great many businesses without the adequate records?—Mr. Harris: Yes. We have not suggested, Sir, that we should treat every asset and attempt to allow for replacement on the replacement cost of that specific asset. I think we are quite conscious of the very great difficulties which would follow, particularly with smaller companies. What we have suggested is that the depreciation allowance should be adjusted to allow for, shall we say, a change in the relative price index in the particular year in question compared with when the asset was bought, which is quite a different matter. That, I submit, Sir, is not too difficult, because however small the company is, it ought at least to have a record of when its assets were bought. It would not force it therefore to attempt to find the replacement cost of each specific fixed asset. I think also, although there are theoretical objections to the latter method, it is for that reason, apart from the difficulties of computation, that we have suggested something on a very much easier and more applicable basis.

3384. You would say that whatever depreciation allowance you are making in the year, according to the method applied by the company, you adjust that by some factor which is based on price for the year?—Quite.

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3385. That is the substance of your suggestion?—Yes, and that factor could, we submit, be decided upon, by some impartial authority, apart from the individual trader. We think it would be far too dangerous to leave it in the hands of every single trader to decide the particular price of replacing one specific asset.

3386. But you are thinking of a static adjustment which is set by some authority which makes the rule?—Yes.

3387. And what happens if you have to face a considerable fall in prices over a few years in the future?—*Mr. Kinney:* It would mean, Sir, that we would allow the historic cost. In other words, we would allow depreciation allowance as a basic allowance based on the actual cost, not less.

3388. So you would never recover less than your expenditure?—Never recover less than expenditure.

3389. Would that not be rather getting the best of both worlds? Supposing there was such a fall in prices that over a period of years it did not allow you to recover the historical cost before the end of the life of the asset, why should you then turn back and say, we should have at least the historical cost?—If assets have been purchased at a price which is too high, which cannot be recovered later out of the revenue of the business, it is obviously a bad investment. If later you were allowed to decrease your depreciation allowance because prices have fallen, you would remove all control on an efficient investment. You would place into the same position the trader who buys dear and the trader who buys cheap. The trader who bought assets at a price considerably higher than they are worth now, made a bad investment and he must recover his cost over the useful life of the asset, and if he cannot recover it he makes a loss.

3390. I would just like you to enlarge upon your statement in paragraph 27 under the heading "Existing corporate taxation and the availability of capital to industry". You say, "If there is some doubt about this"—that is, whether the replacement provisions are sufficient to achieve replacement—"there is certainly no doubt that net retained profits are insufficient to allow, in addition, the building up of adequate financial reserves to cover the unforeseen contingencies of the future." Now what statistics or material figures have you got that would support that?—*Mr. Harris:* Would you turn, Sir, to Appendix F and Appendix G?

3391. Yes, those are the two I have in mind. It would be rather useful if just at this point you told us what were the particular features of F and G that you want us to concentrate our attention on.—First of all, Sir, the retained net profits have of course risen over the period, and it will be seen from Appendix F, Capital Employed, Liabilities, Section 5, Reserves that the figure for reserves in 1938 was £29.4 million as compared with £118.4 million in 1950. Now that admittedly is an increase, but we maintain it has been possible to build up that increase only as a result of a very severe detourment of dividends. If, Sir, you will turn to the Appendix G, Profit analysis, you will find that on Total Income, line 3, you have £22.2 million in 1938 and in 1950 you have £71.7 million. Yet the dividends distributed were increased only by £1.4 million, namely £7.0 to £8.4 million. We submit primarily that the increase is undistributed profit, or shall we say, the amount which has been ploughed back into businesses again, has been possible only as a result of a very severe restriction of dividends.

3392. We can express it in your percentage figures, can we not?—Yes.

3393. If you look at your line 13 in Appendix G, you see that the rise from 1938 to 1950 of dividends has been from 1.0 to 1.2, is that right?—Yes.

3394. Whereas the total income, that is your line 3, has risen from 1.0 to 3.2?—Yes. 3.3 actual trading account; 3.2 total income.

3395. Yes. That is one thing we note. Now what other features do you want us to dwell upon while we are on F and G?—Well, the actual structure I think you ought to be acquainted with because obviously figures of this sort could be distorted and give distorted views without much difficulty, and also because you have probably been acquainted with the figures prepared by the Bankers and also the Federation of British Industries. We feel it

important to stress in this particular connection the great care which was taken with the preparation. They were actually prepared by "The Economist" Intelligence Unit which had 2,708 companies' reports available. It prepared those reports to ensure that only those accounts which were drawn up on a comparable basis were included, and having reached a small number of 50 which were included on that basis, the actual sample that was prepared was based on the accounts of 24 companies. Great care was taken so as to avoid any undue bias and the basis of weighting was according to the contribution to national output of the industries. Now, of the 24 companies actually taken, 10 were in the engineering and allied groups. The general structure, of course, of the net assets of the companies was also important. Without going into too much detail, of the 24, 8, or one third, represented companies with net assets of less than £1 million. We feel, therefore, that the figures we submit are a fair guide to the general trends throughout the period and that there is no undue distortion or element of bias.

3396. I think at one stage in your evidence—we were looking at F—you drew attention to the change in the distribution of these companies' assets between current assets and fixed assets over the period 1938 to 1950.—Yes. The particular point we wished to bring out at that stage was, I think, the fact that fixed assets have not in real terms increased between the two dates. It is necessary to look at the same time, Sir, at Appendix A, namely, that one which gives you the average cost of replacement. There you will note that a place of plant, say, which cost £100 in 1938, cost £243 in 1950. Now, by applying that ratio to your fixed assets you will note that the real figure of fixed assets has probably diminished, where in actual monetary terms the 1938 £s were represented by 100.7 million, whereas in 1950 they were represented only by 149.5 million, namely an increase of £48.2 million. Current assets had increased three-fold from £80.2 million in 1938 to £236 million in 1950. Of the stock was from £37.5 million to £144.8 million. If you refer to Appendix B you will notice that the index for 1950 for raw materials was 425, compared with 100 in 1938. That was the worst case, admittedly, of the three. Finished products were only 209 compared with 100, and I think that a straight arithmetical average may not be too unfair, considering raw materials and work in progress together. It is obviously impossible to be precise. I suggest that that is a reasonable statement.

3397. Apart from those two tables, F, and G, and what we can draw from them when we go into them in detail, is there any other material that you have in support of that statement: "There is no doubt that net retained profits are insufficient to allow the building up of adequate financial reserves"?—*Mr. Kinney:* If you look at Appendix F, you will find that between 1945 and 1950 the actual cash reserves have fallen from £42 million to £38 million, while stocks have increased from £77 million to £144 million. Indebtedness has increased from £89 million to £150 million.

3398. Yes. Now, would you pass on to paragraph 29? I think you are still on the same argument. You are saying there, "the fact is slowly emerging that sources of capital external to the firm are gradually drying up." That is a phenomenon we have got, in the 20th century competition in the markets of the world, to face. In paragraph 31 you say, "Hence it appears to us essential, for the welfare of this country, that it should be in a position to seize the initiative in new industries. If it cannot compete successfully in lines where there is a premium on very large scale production, then it must make its effort along other channels, in new spheres, where it can establish a lead in novel or high specialised processes which do not admit of mass production. But to do this, capital must be available to move freely and a high premium must be placed on the mobility of capital and of other resources. The tax policy should be developed to prevent the ossifying process which now appears so prevalent." Have you in mind a system of taxation like, let us say, a corporation tax, which would separate the taxation of business incomes or company incomes from the general structure of taxation of individuals?—What we want to convey here is this, that on one hand the principle should be that retained profits should not be used for the purpose of maintaining the present size of production but should in principle be used for modernisation, extension or for

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provision of reserves, and that, as it is today, where retained profits have to be used to maintain the present productive capacity, and an expansion of business is hampered in two ways; first, aggregation is diminished, and second, new capital for the purposes which would give the highest yield is available only to a very limited extent.

3399. Yes, have you considered whether, if you had a separate system of taxing business incomes, company incomes, the Government would be able to facilitate what you have in mind more easily?—*Mr. Harris*: No, Sir, we have not considered that specifically. If I may just go back on the previous question, I think in addition to what Mr. Kenneth has mentioned, we also feel that it is essential to free the profits. By that I mean profits in excess of those which are available after allowing for replacement of fixed assets to maintain roughly the same productive capacity. It is essential that those profits are available for distribution so that, once again, there is an increased mobility of capital in the country, capital available to be poured into any particular new enterprise which this country may suddenly be able to develop to replace some of the older industries which, over a period of years, must necessarily die out. In particular when considered along the lines of capital potential it must be admitted, I think, without going too much into the sphere of politics, that certain countries in the world are very much better equipped than we are in a small island with a relatively small population, to cope with mass production, and therefore they are able to produce certain articles at a lower price per unit than we can. Therefore we felt that our only possible hope for re-establishing Britain in the former position which existed before the first world war was if we were able to develop new industries where the premium on mass production is not so high as in some which exist today. We cannot see how these industries can be developed unless capital is in the hands of the private investor and is not necessarily in the hands of any outside controlling body.

3400. Then you are urging a policy, are you, which would allow as much distribution of income made by businesses as is possible to the proprietors so that they could make it available again for these new ventures that you have in mind?—*We* are suggesting that the position before the war at least should be re-established, that it would not be unfair in any social sphere if at least the same proportion of net profit were available for distribution. We feel that the figures we presented show that businesses have been able to maintain productive capacity only (this is one of the reasons) by severe restrictions of the amount of dividends and we feel that is not wholly desirable. We feel also, I think I might add at this stage, that the desirability or otherwise of following such a policy depends on a personal conception of social justice and we have not overlooked that entirely. But we feel also that in order to achieve anything there is very often a price to pay, usually a price to pay, and we put in round terms the possibility that in order to avoid economic stagnation we may have to allow a larger distribution of dividends.

3401. I think you are leading up to a suggestion, are you not, that the profits tax is not a satisfactory form of tax to further the object that you have in mind?—*Quite*.

3402. What are its special demerits: that it distinguishes between profits retained and profits distributed?—*Mr. Kenneth*: The profits tax as such, I think, a deductionary tax so far as it fosters, it encourages, capital investment without the efficient control of cost. There is a difference between the marginal private cost and the marginal social cost. The marginal private cost is much lower. The trader buys a machine, it costs him relatively little and therefore with the profits tax you encourage expenditure on a more lavish scale and the use of resources which otherwise would be for productive purposes.

3403. Why should it encourage expenditure on a more lavish scale?—*He* has to retain his profit in the business. If he does not spend it he will have to pay tax. It is, I think, quite well known that on the impact of profits tax all sorts of expenditure has been made and is being made which would not have been made if the profit calculation were more correct. It costs so much less to buy an asset if 65 per cent. of it is allowed by tax.

3404. O's yes, I see. You are stressing, from your view, the drawback?—*The* very high taxation, particularly of the profits tax, which differentiates between retained and non-retained profits.

3405. I see in paragraph 50, you are referring to "the general trend of emigration of companies situated in this country which operate abroad." I am not quite clear. What do you make out to be the prime cause of that trend? The high level of taxation in this country? The unfairness of taxing companies because they are controlled here on all the income which they make abroad? Local pressure in the other countries? What is it that you are concentrating on?—*I* think it is particularly local pressure, but I think it would be wrong to overlook the possibility for a company of saving £2 million in tax if they just change their domicile.

3406. So far as you are in touch with the matter, what do you think is the prime cause of this movement, and what should be done to stop it, if it can be stopped?—*Relatively high taxation. I* know that the 1951 Act makes certain allowances for this, but if one compares the taxation which companies are subjected to in Britain and abroad, it still is at a disadvantage. The Americans exempted companies operating abroad from the United States tax unless the profit has been brought in.

3407. That is the American practice?—*Yes*.

3408. So you first of all contrast all companies whose income becomes liable to United Kingdom taxation with their competitors who are subject to another system of taxation, but do you also contrast our system of taxation with particular enterprises like mining, with other systems?—*Yes*.

3409. And from what point of view? Do we hear more hardly on their profits?—*Yes*.

3410. In regard to allowances for depreciation and so forth?—*Yes*.

3411. *Mr. Kaldor*: I should like to ask a few questions first about your figures. You would regard these as giving a reasonably representative picture?—*Yes*.

3412. And you would say that the group of companies represented in this sample, Appendix F and G, had about the same amount of fixed assets in 1950 and 1938?—*Mr. Harris*: Yes.

3413. That was your view in answer to the Chairman?—*Quite so*.

3414. I would like you to interpret these figures a little. In 1938 this group of companies put aside for the purposes of replacement and expansion, according to your figures, the following sums: Depreciation, £4.3 million; Appendix G, item 6; Appropriations for reserves, £3.1 million; item 14; Retained in subsidiaries as reserves £0.5 million. The total is £7.9 million. According to your own figures, Appendix A, the rise in replacement cost of fixed assets on the average was 150 per cent, or rather, the index figure was 243. So that, in order that the same group of companies should retain for replacement and expansion the same real amount as they did in 1938, they would have to retain £20 million; I say £20 million because it is roughly 2½ times £7.9 million. You get the figures of what they actually retained in 1950. Under depreciation they retained £14.3 million. Under reserves, £15.5 million. Reserves retained in subsidiaries, £1.5 million. The sum of those three items is £31.2 million. Therefore, they retained 50 per cent. more for both replacement and expansion in real terms than they retained in 1938, on your figures.—*Yes*, but surely you have also to take into account not only fixed assets but your stocks and work in progress. Those items have got to be financed to maintain the same physical level of production. Take a tobaccoist, for instance, without any plant, where cigarettes before the war were 10 for 6d. and now they are 10 for 1s. 9d., say. He would have had to have left profit in the business in order to finance the same physical volume of stock.

3415. Was it not usual before the war for firms to borrow quite liberally against requirements of working capital?—*Yes*.

3416. I never heard it as an accepted principle that firms must finance increased requirements of working capital out of retained profits.—*But I* think if they had not been able to borrow from the bank since the war the

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level of stock today would have been very much lower than it would otherwise have been with a large company; but I am thinking very much of the smaller company of £5 to £10 thousand capital, one without the same ready access to the bank, without the fixed assets that offer a security; it must necessarily retain its profits if it wants to maintain the same physical volume.

3417. *Sir Geoffrey Heyworth*: The amount of borrowed capital here is, in Appendix F, £1.5 million.

3418. *Mr. Kaldor*: Yes. Your point is that this sample of firms have not increased their fixed assets: they were not larger than before the war?—Quite.

3419. Presumably these are the same figures for depreciation as are allowed by the Revenue. The Revenue allowed them £14.2 million in 1950 as against £4.3 million in 1938, an increase of more than 200 per cent.—Yes.

3420. How do you account for it?—The initial allowance, I should say, would be a major factor there, Sir. After all, the initial allowances were 20 per cent. in 1945 and increased to 40 per cent. on, I think, 5th April, 1949. For any losses or gains you had as much as 65 per cent. the first year and that I think is the major factor affecting that particular figure.

3421. I see. Well now, perhaps I can go on with this. I find that what they have actually retained, the net amount set aside in the business, was just four times what they retained in 1938 in money terms, while prices, on your calculation, were $2\frac{1}{2}$ times as high?—For fixed assets.

3422. Yes. I would not like to follow your argument about working capital. Now the amount paid as taxation has gone up very much; on the figures here, from £4.8 to £24.2 million. That largely reflects the increase in the general rates of taxation, does it not?—Yes, and also, I should say, the higher figures on which it is assessed, owing to inflation.

3423. Yes, quite obviously. Well now, supposing this group of companies had been subject to the same increases in the rates of taxation as they actually were subjected to, but that inflation had not taken place. One could eliminate the effects of the inflation by deflating the figures by some general price factor; such as those given in your Appendix A (I am not carrying out this calculation. I cannot very well hold up the Commission by doing that); if you had done that, would you have found that the equity shareholder would have been better off or worse off in the absence of inflation? In other words, without inflation the net profits remaining in the business plus the ordinary dividends distributed would have represented a larger amount in real terms than it actually represented on these figures?—I cannot answer with the aid of any specific figures because I have not got them out.

3424. I suggest to you that if you take into account that, on the one hand this very much swollen depreciation figure must be due, apart from initial allowances, to the fact that a great deal of the assets in these companies have been replaced at enhanced prices after the war so that higher replacement cost is placed on them, and on the other hand, that the burden of debenture and loan interest and of preference dividends has fallen with the rise in prices, that the shareholders of this group of companies on the whole benefited from the inflation, even taking the nature of taxation into account. I think you could work that out with the aid of your own figures. But some of the figures would have to be estimated, for example, what the depreciation allowances would have been.—*Mr. Kenner*: I think that if we recalculated the actual profits, over these interim years, it is very doubtful whether it would, according to the principles which we would like to apply in calculating profits after charging proper depreciation; I am very doubtful that the profits which would then accrue to the shareholders would show an inflationary benefit. The inflationary benefit is only the result of the method of accountancy which does not take into account the depreciating value of money.

3425. I am afraid I am unable to follow you there.—We have not calculated that. It is only an opinion.

3426. You mean that you would show a higher amount of depreciation and a lesser amount put to reserve?—We would show much less profit.

3427. As far as the money set aside in the business is concerned, whether it is in the form of depreciation or in

the form of reserves, it comes to the same thing; the difference after all is only one of accounting. What did you intend these figures to show? Did you intend these figures to support the proposition that inflation drains away the finances of companies, that they are therefore in a much worse position than they would have been without an inflation, because I suggest to you that your figures have singularly failed to support such a contention.—*Mr. Harris*: If I may answer that, I should say that they tend to maintain, that they support several specific points. The first is, they are evidence of the reduction in real terms of the return to shareholders in actual dividends. Secondly, we maintain that they show that fixed assets expressed in real terms and stock expressed in real terms, other than the particular stock units of the year in question, have not increased. Therefore if that is the case, the liabilities of the group, the current liabilities and provisions which show £23.9 million in 1938, and in 1950, £150.3 million, to other than the owners accrue.

3428. *Chairman*: Can I have those figures again?—Yes. Appendix F, 1938, 10 per cent. as expressed in percentages in 1938, and 33 per cent. in 1950. The debentures admittedly had fallen. I think one must take that into account, although there were large issues of debentures, you will remember, at the end of 1950 and these figures are for the accounting years ending 1950. If you notice, the shareholders' interest over the period 1938-50 is progressively smaller. At the end of the period 1950 the total share capital and reserves amounted to 57 per cent. of the total liabilities, or total assets, whereas in 1938 they represented 67 per cent.

3429. *Mr. Kaldor*: Can you repeat that?—Yes. Numbers 4 and 5, share capital and reserves, under "Capital Employed: Liabilities". In 1938 you had 67 per cent. of the total fixed assets of £217 million owned by the shareholders, in one form or another, either as original capital or as money left in. In 1950, 57 per cent., a reduction, in other words, of 10 per cent.

3430. These are the two points?—They were the main points.

3431. May I take you up on those two points first? First of all, the ordinary shareholders: in Item 13, Appendix G, you show the ordinary dividends after tax?—*Mr. Harris*: Yes.

3432. Is that the correct procedure in this case? After all, what we are trying to see is whether the ordinary shareholder has fared too badly in relation to other groups. If income tax goes up from 5s. 6d. to 9s. 6d. or 10s. 6d., as it did in this period, you would not expect that the company should compensate the shareholders for the rise in income tax by higher dividends? We cannot all claim higher salaries from our employers when income tax goes up?—But higher salaries have been paid to a very much larger extent over the period than dividends have increased.

3433. Higher salaries gross, but I am suggesting to you that in order to show what happens to dividends you should show them gross of income tax and not net. If you make the adjustment the increase is not from £5 million to £5.8 million but more like from £5 million to £8 million, taking into account the rise in taxation. You would get in effect a pretty considerable increase in dividends?—In gross dividends, yes, between 1938 and 1950.

3434. Yes. I suggest to you that since the amount retained in reserves has gone up from £7.9 million to £31.3 million, these companies would have been in a position to distribute the same real amount or a higher real amount in dividends and at the same time to set aside a higher real amount, a higher amount of reserves in real terms and not merely in money terms, than they did before the war. Now I come to your second point. I believe the significance of these percentage figures you have given to us is purely spurious, and the reason is that in these balance sheets the fixed assets are stated at historical cost, whereas current assets are entered at current prices. Obviously, in a period of inflation the fixed assets being entered at pre-war prices become a diminishing proportion of the total. In other words, if for the purpose of this problem you were to revalue the fixed assets in the balance sheets of these companies and enter their fixed assets at current values and not

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in terms of historic cost, you would find that the proportion represented by the shareholders' interest in the total capital employed would not have gone down from 67 per cent to 57 per cent. Do you agree with that?—I do not necessarily agree, because you are distorting the difference between the two types of asset. There was an enormous amount of purchasing immediately after the war. The requirements of industry in 1945 were very considerable, and therefore the difference is not as great as you would suggest. Secondly, I do not quite follow your statement about stocks being valued on the market current basis. Admittedly the time lag is smaller, but it is still the historic cost of the stock.

3435. It is the historic cost of the stock, yes, but of the recent past?—Of the more recent past, yes.

3436. Would you agree that a lot of companies recently have for their own purposes and for the purposes of their shareholders re-valued their assets in their balance sheets in this way?—There has been a move in that direction in the last year or two.

3437. In those cases the value of the assets has gone up very much?—Yes.

3438. There are in fact large hidden reserves due to this factor. If a revaluation takes place, then a special reserve would appear in the balance sheet?—Yes, re-valuation of the assets would increase the figure.

3439. That factor might easily account for more than the percentage fall that you have indicated?—I should be surprised if it did. It is impossible to prove it.

3440. Is there any further point you wanted to make in connection with these figures?—No.

3441. Turning from these figures to the general question, your contention is that business should be free of taxation on whatever is necessary to maintain the real capital intact?—Yes.

3442. That is not a general principle of taxation, is it?—No.

3443. For everybody else we have to work on a money basis?—Mr. Kennett: That is not quite so. If we accept that income tax should be levied on income and nothing but income, then in order to levy tax on the income of businesses you must first determine what is the income of the business. That is all we wanted to say.

3444. That depends on your definition of income. You can define income as whatever remains after maintaining money capital intact; that is one definition; and you can define it as what remains after maintaining real capital intact, and that is another definition. You might choose either definition. Is it not necessary to be consistent, whichever definition you choose?—I do not think we would worry very much about the definition as such, but from our point of view income is not earned unless you have earned it while keeping your capital intact. That was a principle which was accepted one hundred years ago, when Parliament compelled companies to use the system that we later called the double account system, and imposed upon the companies the obligation to show every year the volume of assets in the business had been maintained in perfect order and condition at the end of the year, and only the revenue which was left after all their expenses had been carried down was called profit.

3445. The question we are discussing is whether what we call profit should be what remains after setting aside enough to recover the money put into the business, or as you contend, after setting aside enough to maintain, to recover what you have put into the business, not in the same money unit, but in the same real unit, in the terms of the same purchasing power?—Let me give you an example. You have a machine on which you replace one part. This part costs you £5. You put it as an expense into your current account. The depreciation of the machine itself, however, you calculate not at the cost of this year but at the cost of twenty years ago. I submit that if you do that you just deceive yourself.

3446. Is there anything to prevent a firm from undervaluing itself by drawing up its accounts in a different way? We are considering this problem here in relation to taxation; we are not considering whether you should deceive yourself or not. All I am interested in here is whether it is just to change the definition from a taxation point of view. I may agree that from the point

of view of the interest of shareholders there may be something to be said for changing the methods of drawing up the accounts. If you establish it as a principle that business is entitled to tax-free depreciation of whatever is necessary to maintain the real capital intact, should not the same principle be also applied to the taxable income of individuals, or is there some special virtue in business which makes it necessary to apply a more generous rule in the one case than in the other?—My answer to you, Sir, is this. The question you raise may be a question of monetary reform but not a question of accountancy. We use money in accounts for two purposes. The one is to reckon what we owe and what is owed to us, and the other purpose is to use it as a yardstick to represent real values. If we use a wrong yardstick, if we use money to represent real values in the wrong way, we obviously get a distorted account, and our object as accountants is to produce correct accounts, and therefore we try to establish ways and means by which we replace or supplement money as used for certain accountancy purposes.

3447. In other words, you are concerned with a reform of accounting, not taxation at all?—It is a reform of accounting, but it would be useless as a reform of accounting if the Inland Revenue, which takes the major proportion of profits, would not accept it. I would not say it would depend entirely on the Inland Revenue accepting this principle. We could introduce it even if the Inland Revenue would not accept it, but it would be futile from the general point of view if the Inland Revenue, which takes the largest share of the profit, should claim a different method of calculation than the one we consider is correct.

3448. But you should appreciate that if the Inland Revenue were to take the line that their main concern is to be fair between the different classes of taxpayers, they would be unable to advocate a reform that does not satisfy these criteria of fairness. That should not prevent you from advocating a reform of accountancy for the purpose of shareholders that would in your view more honestly record the trend of results which the accounts should exhibit?—Mr. Harris: In other words, you are considering that we would be giving an unfair advantage to the shareholders in regard to the rest of the community?

3449. Yes. We all act on the basis of a stable value of money up to a point. When the value of money becomes violently unstable we may have to give up this fiction, however regretfully?—Yes, quite.

3450. For example, in Germany in the 1920's inflation proceeded to lengths at which the fiction of a stable value of money could no longer be maintained. When once you reach that stage, it may be necessary for Parliament to introduce something like a general revaluation of contracts to protect the interests of the lenders, to prevent the debtors from being completely expropriated by the debtors?—Yes, we agree that there may be some substance in that, but we do not feel it is within our preview to suggest it here this afternoon.

3451. You might consider that in the absence of such a general revaluation of contracts, if you were to pick out a single reform such as the tax-free allowance on replacement costs, it might create more injustice than it would solve?—I have already mentioned, in answering a question put by the Chairman, that social justice must affect one's decision. That is why I brought it in at that stage. But I submit that there is a difference; it does not wholly cover the point, but I submit it does go some way towards it. In the first place, the amount of capital used by industry bears no relation whatsoever to the very much smaller quantity used by individuals. Actually, fixed assets themselves are not brought into account and the replacements are not brought into account in computing individual incomes. Therefore, I think company income is on a different plane. Secondly, the ordinary shareholder has submitted his money to a risk, unlike the employee, who agrees to work for a certain fixed salary or income. It is a doubtful amount how much the ordinary individual shareholder will receive. Therefore, he is entitled to some reward for that additional risk. As I have mentioned, I feel the injustice which I agree with you would be created without wider monetary reform, which I am neither competent nor prepared to discuss this afternoon—that the injustice must be offset in my opinion, by the possible stagnation which would possibly result from the continuation of the present system.

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MR. LEO KENNETT AND MR. J. E. HARRIS

[Continued]

3452. You would agree that the danger of stagnation is potential rather than real?—I should say we are already witnessing it to some extent in the smaller companies; I cannot give you first-hand information of the larger ones. In the smaller ones there are the difficulties of getting loans from the bank and outside finance in order to meet the ever-increasing cost of stocks.

3453. If more finance were forthcoming either in the form of reduced taxation or easier bank credit or easier borrowing in the free market, what do you think would happen? Would there be more real capital created?—There would be more preparedness to take risks as a result of which you have the opportunity to create new capital.

3454. Chairman: That is a very wide question.

3455. Professor Hicks: When you were going through these accounts with the Chairman, it seemed to emerge that it was because of the initial allowance that the figures gave as good an effect as they did on a correct interpretation. Of course, now that the initial allowances have been removed, I take it their effect has disappeared. If at some future date the Government were to contemplate the reintroduction of initial allowances, I take it from what you say you would rather go on to a method of depreciation by adjusted costs or something of that sort rather than go on to a method of initial allowance?—Mr. Kennett: Certainly.

3456. I see that you have presented very strong accounting arguments for that course in the sense that it would tend towards a tidier and more intelligible system of accounting generally. Apart from those accounting arguments, are there any very strong reasons in favour of the course which you recommend?—As to the initial allowance, I would venture to say this, that they distort not only the picture of the accounts but they keep it distorted for some time, because there will have to be a reserve against initial allowances for the future years. I think initial allowances contributed to some extent at least to the inflationary pressure we have witnessed in the last three years, particularly since it was known they were going to be abolished. To put an instance, the number of commercial vehicles which have been bought in the last two years by the home market were excessive, so excessive that a special tax had to be put on them. One of the reasons why this buying has been concentrated during the last two years was to some extent at least that through the effect of the initial allowance a large part of the capital outlay was recovered in one year at a time when profits were good.

3457. Is not the moral to be drawn from that rather that the initial allowances were given at the wrong time?—I think they are wrong in principle. If we follow the general line that there should be no difference between the accounts which we produce for all interested parties, the shareholders or wage-earner or the Inland Revenue, the initial allowance distorts our figures and induces us to buy new capital goods while the going is good. We complain that the consumption of capital goods by the home market was excessive, and that exports of those goods which the foreign market wanted most were not free. One of the reasons certainly is the initial allowances system.

3458. May I ask just one more question? If the choice was put before you, not whether you prefer the initial allowances or the system of depreciation allowances which you have been recommending, but whether you prefer that system of depreciation allowances to a straightforward reduction in rates of taxation which might carry with it perhaps a simplification of profits tax, excess profits levy and so on, which would you rather have?—You put me in a difficult position. As an accountant I would like to tidy things up. I would like to have accounts made so that they are generally capable and useful for all purposes. That does not apply only to initial allowances, but it starts with special depreciation allowances on industrial buildings and mills, while commercial buildings did not get it. We would like to induce the Inland Revenue to treat accounts as they should be treated, as giving a fair and true picture of the results of a certain given period of any particular firm, and take the decisions on taxation and general economic policy after they have taken that into account.

3459. Mr. Crick: Mr. Kennett, your case for adjustable depreciation allowances rests very largely upon what has happened in the past, or, as you put it in the memorandum that you put in, in the last ten or fifteen years?—Yes.

3460. But it also rests upon your fears for the future, and particularly upon the prospect, as you see it, of a perpetual instability in the value of money. I take it that you are not thinking just of the ordinary ups and downs that are inseparable from trade fluctuations, as we have known for many, many years past, but you are thinking of real upheavals in the value of the currency?—I would not go that far, Sir. I would not fear real upheavals, but what I would fear is that the value of money over a long period did fluctuate even at a time when the value of money was a prime object of economic policy. In the second half of the 19th century we did see a gradual decline of prices even at a time when monetary stability was the assured object, the prime object, of the economic policy. To-day monetary stability, I think, is no more the prime object of economic policy, but full employment or other objects. Monetary policy ranks, I think, to-day not as one of the principal objects of economic policy. Therefore it would be difficult to take it for granted that all measures will always be taken for the purpose of maintaining the purchasing power of money. That is what we mean by the possibility that fluctuating values will continue in the future.

3461. So that you would have preferred, for example, that the kind of system you are now recommending should have been in force, let us say, in the second half of the 19th century just as much as to-day?—Yes.

3462. I want to get clear on that point, for this reason among others. Supposing your adjustable allowances were in force, that would mean, would it not, that at a time of rising prices your depreciation allowances would rise, therefore your tax payment would fall or would not be as large as it would be under the present system?—My profits.

3463. And your tax payment?—So far as it is based on profit, yes.

3464. Your tax payment would be smaller than under the present system of calculation?—Well, if the rate remained the same and the basis on which it is calculated becomes levelled down, the result would be smaller.

3465. Would not that in itself, multiplied over thousands and thousands of companies concerned, tend to relax the defences against further inflation?—I do not think so, Sir. If I may say so, it is not quite within our province as accountants, but it seems to me that the heavy taxation of companies' profits has, not a disinflationary, but an inflationary effect. It very much reduces the propensity to control costs and induces expenditure, which under more strict control would not be done. The question is whether if you were to pay out a larger percentage in dividends those recipients of dividends would spend more than the companies themselves. It is a very moot point. It is well known that under the impact of these very heavy tax companies' expenditure has gone up quite a lot.

3466. Would you mind just interpreting one passage in your document for me: it is in paragraph 36. You refer to differential treatment in the statutory taxation. Do you see the phrase: "Equally the view is taken that differential treatment in the way of additional statutory taxation . . ."—Yes.

3467. I was not clear, reading that, just what differential you are referring to?—I think one must read that in conjunction with the first phrase. In the first phrase we say there does not appear to be any objection to the tax levied on the companies' profits at the standard rate of tax, which would be the same, or approximately the same, as individual incomes. But then we say that, this being so, we think it is wrong to levy on companies in addition to standard tax the 10 per cent. profits tax.

3468. I see. You are not there objecting to the differential between 50 per cent. and 10 per cent.?—No, we object to the 10 per cent.

3469. I want to ask you, if I may, a domestic question. I am under the impression that a very large number of your members are in private practice as accountants?—Yes.

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Mr. LEO KENNEDY and Mr. J. E. HARRIS

[Continued]

3470. I hope your experience will help me here. Would you say that a very large part of the activity of your members is taken up in tax matters?—Mr. Harris: Yes.

3471. Would you say you are on the whole more occupied with tax matters now than you were before the war?—Yes.

3472. Is your concern in these matters growing or diminishing?—Growing, I should say.

3473. Would you say it is due more to the increasing sensitivity to taxation on the part of the taxpayer or to the increased complications of the system of taxation?—I should say both. Obviously it is impossible to segregate one from the other in measurement, but comparing, for instance, the intricacies of the 1945 Act regarding wear and tear, and the difficulties involved in even normal computation of balancing charges and allowances, compare this with the relative simplicity of the wear and tear provisions before the war; the difficulties of profits tax in relation to the comparative ease with which it was possible to compute the National Defence Contribution in 1938. Now, of course, you can compare that with the Excess Profits Levy, which in turn you can compare with the Excess Profits Tax of the war. But if you are thinking of the period up to 1939, you can say we have one more tax today than existed before the war. I think the answer is most definitely "yes" to that question, and also most definitely "yes" to the other question, because it is reasonable to suppose that our clients will put more pressure on an accountant to obtain relief of £X if that £X is going to be subjected to tax at 5s. 6d. in the £ or a greater sum for profits tax than he would if it were subject to tax at 4s. 6d. in the £.

3474. Do your troubles arise mainly in connection with taxation of business profits or personal taxation?—I imagine it varies considerably from province to province, but speaking personally it would be definitely business and not individuals.

3475. Would you say the small business in particular?—The definition of small business being anything up to, shall we say, £20,000 capital?

3476. Yes.—There again, of course, with a practising accountant who is normally dealing with that sort of business, naturally, the whole of his increased worries arise from the complexity of small business taxation. It is difficult to segregate.

3477. Do you think your recommendations would add to or diminish the problems arising from the taxation of profits?—Conceivably they would add slightly, although, as I pointed out to the Chairman earlier, the method it is possible to contemplate would be one that would add very little to them. In any case, it would also be an accounting matter, would it not, apart from tax?—Mr. Kennedy: It would simplify generally the position, because if you manage to have one set of accounts which you prepare in any case, and if we could manage to have these accounts kept the same for Revenue purposes as well, I should say the complication would be rather diminished.

3478. There is one other point at the very end of your memorandum. You are mentioning some objectionable consequences; as you see them, of the present system of taxation. You cite the encouragement of extravagance, the reluctance to take risks, and the encouragement of certain activities of which you evidently disapprove. Could you give me any examples of the kind of activity that you are referring to under your heading there, which you describe as unorthodox?—Mr. Harris: Well, unorthodox, I suggest, is a word which has quite a wide cover, and I think we were thinking in that particular connection of, for instance, the change in partnerships solely to avoid liability to tax rather than from business reasons, which were covered and dealt with quite fully in the Tucker Committee Report. There are quite obviously a lot of other even more objectionable practices. But I do not know how far I may express them in public. For instance, the employment by directors of the wives of other directors in other companies in order to, shall we say, get additional income. I would rather not pursue that too far but merely cite that as an example.

3479. I am wondering what is the real proportion of this kind of thing by comparison, for instance, with the extent to which assessment is escaped by reason of the difficulty of the Inland Revenue in catching up with

assessors. You are aware, for instance, that the last Annual Report of the Inland Revenue states* that a systematic search was begun to discover persons who have escaped liability, and that has produced 40,000 new cases, mostly small traders. You would not suggest that by the side of figures like that the sort of thing you have in mind was at all substantial or worthy of very much attention?—It is so difficult to compare one with the other. I think one could say it has reached sufficient size since the war to make one feel a considerable amount of disgust that it should be in vogue. In my discussions with practising accountants I have been led to believe the increase has been very considerable, and that doubtful practices are not frowned upon today to the same extent as they would have been twenty-five years ago.

3480. That development is simultaneous with the great increase of the burden of taxation, but would you say it was caused by the increase in that burden?—I am sure I am not suggesting that original sin is any greater. I quite agree it is an encouragement to dishonesty, yes.

3481. Mr. Corrigtton: Taking up the last point, you mentioned that there was avoidance or evasion of taxation by the change of partnership?—Yes.

3482. Have you read the Tucker Committee Report?—A long time ago.

3483. Do you remember certain suggestions were made regarding partnerships?—Yes.

3484. Would not the implementation of those recommendations do away with that practice to which you are referring?—Yes, as far as I remember, they would.

3485. You also mentioned practices in connection with limited companies' employment of directors' wives. Was your reference based on personal experience?—Yes. When you say personal experience . . . ?

3486. Companies where you saw that happen?—No.

3487. In other words, on hearsay?—Yes.

3488. Do you know whether these companies are public companies or private companies?—As far as I remember, private companies—quite small.

3489. Would you agree that that type of avoidance is seldom, if ever, met with in public companies?—I should imagine that is a perfectly true statement; it is seldom met with in public companies.

3490. Would you agree the auditor would have a duty to perform if he came across that sort of thing?—Yes, quite. Mr. Kennedy: I should say it would be quite impossible in a public company.

3491. In other words, it is restricted to the smaller type of business?—Yes.

3492. Taking you into what you describe as your own province of accountancy, would you mind turning to paragraphs 25 and 26 of your Memorandum? You make two proposals, one in regard to fixed assets and the other in regard to stock. Which of those do you regard as more important?—I think from a general point of view, from the point of view of accountancy principles, the provision for fixed assets I should rate as more important, because that would, I think, imply a change in approach, a change in the basic principles of accountancy, while the stock valuation as such could be done easily within the present framework of accountancy practice.

3493. I am not concerned with which could be done more easily, but which is more important in the interests of the business world?—Mr. Harris: I submit that the provision relating to fixed assets is the more important. I feel that the provision in relation to stock covers a matter which is less invidious, because stock is more quickly turned over than fixed assets.

3494. Would you cast your mind to the accounts of a company with which you are familiar and tell me whether you think their difficulties during the past two years, their financial difficulties, have been caused more by the increase in stock prices than the difficulty in financing replacements of fixed assets as they occur?—Mr. Kennedy: I think in stocks for the last two years.

* Paragraph 76, Cmd. 8436.

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Mr. LEO KENNETT and Mr. J. E. HARRIS

[Continued]

3495. On experience to-day is not stock the more important?—If I may put it so, it is quite true that for the last two years the fluctuations in stock and the money required to carry stock at enhanced price has been a very important item, but it would be surprising if this situation did not peter out on its own within the next few years.

3496. You say "would not peter out"?—It would adjust itself.

3497. Would you mind developing that, because if your point is right, and I do not dispute it, how would it rectify itself?—Either the prices could go down, as they did in the last six months, and the financial requirements for carrying the stock would be adjusted downwards, or the price of the finished products would also have to rise in proportion with the prices paid.

3498. So that the manufacturer . . . ?—He gets back quicker his initial outlay on raw materials than on the fixed assets.

3499. Are you basing that answer on a theoretical consideration of the subject or on actual experience?—In a number of companies I think it is an actual experience, but I quite admit that in other companies I can think of now the demand for carrying a large stock is permanent. It does not fluctuate very much.

3500. In other words, the quantum of stock as distinct from the monetary valuation remains pretty well constant over the years?—Yes. There are some companies I can think of now where the volume of stock remains practically stable or cannot go below a certain minimum.

3501. That being so, would it be right to say that the companies' investment in stock is in some ways in the nature of fixed assets, something without which the business cannot develop?—Yes.

3502. So that would lead you, so far as that type of company is concerned, to support a base stock valuation?—Yes.

3503. Have you had any experience of base stock?—In my personal capacity, no.

3504. Have you, Mr. Harris?—Mr. Harris: No, I am afraid not.

3505. Coming back to the more general point, the proposition you make here in paragraph 26, do you visualise something in the way of the American system, or would you develop on that?—Mr. Kennett: Yes. I think we would like to see adopted here a choice between various established methods to fit individual needs of each firm, or even within the firm the various departments and the various sorts of stock. The Americans have developed a range of stock valuation principles, and they have been accepted, some of them, the more important ones have been accepted, by the American Revenue, and they are established now as well known accountancy principles. So far as I know, there is also a case where the LIFO method has been accepted here.

3506. What would you do in the case of a company if on the balance sheet date market value was less than your LIFO value?—I think, Sir, I would put it like this.

We would retain as an overriding principle the cost or the market value, whichever is lower, but we would use for the interpretation of cost one of those, either LIFO or base stock.

3507. Just elaborate that for a moment. Going back to the example I gave you, the company working on LIFO, taking first of all the accounts, would you keep to your LIFO basis?—If the market value is lower than cost?

3508. No, I want you to assume that the market value is lower than LIFO value?—If the market value is lower than the LIFO value I would write down to the market value.

3509. Would you follow that through for tax computation?—Yes.

3510. In other words, you would go beyond what the American tax law does at the moment?—Yes. From an American taxation point of view I quite realise, LIFO is a one-way street, once you go into that you cannot get out of it. You must take your LIFO basis for quite a number of years; as far as I know, indefinitely.

3511. Not take it for better or for worse, because there is not even a Divorce Court to help you?—I think the drawback of the American LIFO system, if the LIFO basic price is higher than the market value, is that then the profits will be overstated.

3512. So that you are really departing from the economist's conception of profit and income and saying: "I must bring in the lower"?—I am not so sure of that. An anticipated loss would occur anyhow. If I value stocks at the end of the year at a higher or lower price, I anticipate or postpone the profit or loss. I can recover it in my finished products when my price is all right, or I cannot recover it and I make a loss.

3513. One last question, coming to fixed assets. Would you say that the depreciation reserve on the basis of the replacement cost should be made even if it would involve passing the preference dividend?—It is a very difficult question. What you imply is that the recalculation of profits would show that not sufficient profit is available to pay the preference dividend? If that is the position, I should say yes.

3514. If you were adviser to a company you would advise them even now to make this reserve on this basis, even though it involved passing the preference dividend?—The preference shareholders have a right to profits, if earned. If no profit is earned, according to the established accountancy principles, there is no right.

3515. I am asking you what you would do in present day circumstances?—In present day circumstances I cannot claim that according to accounting principles as used at present there is no profit. According to accounting principles as at present in use, I have to show a profit to which the preference shareholders have a claim. If I could show that there is no profit according to accounting principles, then there would be no claim.

Chairman: Thank you very much, Mr. Kennett and Mr. Harris.

The witnesses withdrew.

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MINUTES OF EVIDENCE
TAKEN BEFORE THE

14

ROYAL COMMISSION ON
THE TAXATION OF
PROFITS AND INCOME

FOURTEENTH DAY

Friday, 11th July, 1952



WITNESSES

MR. AUSTEN ALBU, M.P.	} A Group of Fabians.
MR. ROY JENKINS, M.P.	
SIR HENRY CLAY	
MR. C. J. GEDDES, C.B.E.	} Trades Union Congress
MR. L. MURRAY	
MR. F. JONES	

Questions 3516-3667.

Questions 3668-3780.

Questions 3781-3892.



LONDON: HER MAJESTY'S STATIONERY OFFICE
1952

FOUR SHILLINGS NET

TERMS OF REFERENCE
(As amended 11th March, 1952)

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages: to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer: to consider the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden fairly among the individual members of the community: to make recommendations bearing in mind that in the present financial situation it may be necessary to maintain the revenue from profits and income: and, in so far as they make recommendations which would on balance entail a substantial loss of revenue, to indicate an order of priority in which such recommendations should be taken into consideration."

NOTE

For the guidance of intending witnesses the Commission published a list of the main heads under which evidence was invited. They explained that the list was not necessarily exhaustive and that witnesses could put in evidence on questions not specifically mentioned, provided that they fell within the Commission's terms of reference. The list is reproduced below.

A. General social and economic questions

1. Is the present system of taxation satisfactory, or could it be improved, in relation to:—
 - (a) incentives,
 - (b) risk bearing,
 - (c) encouraging savings,
 - (d) the control of inflationary or deflationary tendencies,
 - (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment,
 - (f) its effect on the distribution of personal incomes,
 - (g) other economic and social objectives?

These questions can be considered in relation to the taxation of:—

- (i) salaries and wages (P.A.Y.E.),
- (ii) profits of businesses and self-employments,
- (iii) dividends and other sources of income.

2. Would it be advantageous to link Income Tax with social security payments and contributions?
3. Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

B. Particular matters

4. Is the taxation net drawn too widely or too narrowly in relation to:—
 - (a) the taxation of United Kingdom residents (companies or individuals) on overseas profits,
 - (b) the taxation of non-residents on United Kingdom profits,
 - (c) the definition of residence, etc.?
5. (a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particular—
 - (b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?
6. Is the basis of computing income from property under Schedules A and B satisfactory?
7. Should the present rules about deductions for outgoings and expenses be altered?
8. Are the provisions for relief in respect of double taxation satisfactory?
9. Should the present system of graduation by means of the exemption limit, personal allowances, reduced rate relief and Surtax be altered?
10. Should the existing differentiation between earned and unearned income be extended or reduced?
11. Are alterations necessary in the rules governing personal and other allowances?
12. Should the rules about the taxation of husband and wife be altered (a) as regards aggregation; (b) in any other respect?
13. Should P.A.Y.E. be altered or abolished?
14. Should the principle of deduction at source be extended or restricted?
15. Should the method of assessment to Surtax be altered, and in particular should it be deducted from salaries?
16. Are any alterations desirable in the system of administration and the functions of the various statutory bodies or persons connected with taxation?
17. Are any changes in the provisions against avoidance and evasion desirable?
18. Is any alteration necessary in the rules governing the taxation treatment of special classes of taxpayers (e.g., public corporations, co-operative societies, charities)?

MINUTES OF EVIDENCE TAKEN BEFORE
THE ROYAL COMMISSION ON THE TAXATION OF
PROFITS AND INCOME

FOURTEENTH DAY

Friday, 11th July, 1952

PRESENT:

THE RT. HON. LORD RADCLIFFE, G.C.B. (Chairman)

MR. W. S. CARRINGTON, F.C.A.
MR. W. F. CRICK
MR. J. E. GREENWOOD
MR. GEOFFREY HEYWORTH
PROFESSOR J. R. HICKS, F.B.A.
MR. N. KALDOR

MR. W. J. KISWICK
MISS L. S. SUTHERLAND, C.B.E.
MR. J. MILLARD TUCKER, Q.C.
MR. E. R. BROOKES (Secretary)
MR. D. G. DAYMOND (Assistant Secretary)



MR. AUSTEN ALBU, M.P. and MR. ROY JENKINS, M.P., on behalf of a Group of Fabians; called and examined.

MEMORANDUM SUBMITTED BY A GROUP OF FABIANS

Introduction

1. The structure of taxation is one of the most important instruments available to governments for implementing their economic and social policies. It should, therefore, be judged by its efficacy in furthering the ends of these policies. We regard the principal ends which are relevant to the problems of taxation as securing maximum production, a just distribution of income and wealth, and the provision of the essentials for a full life to every individual in the community.

2. It is widely agreed that the present tax structure has had a substantial effect in two of these three respects. The progressive nature of the Income and Profits Tax structure has considerably lessened the inequalities of income after tax, and the high revenue received provides for an expenditure on social services which makes generally available better education, housing, health and nutrition than ever before. What is frequently disputed, however, is the compatibility of the present tax structure with maximum production. The Commission will no doubt receive representations to the effect that the present level and degree of progression of the Income and Profits Tax constitute a serious hindrance to the country's productive effort. We wish to submit that this criticism is false.

3. The experience of the last five years provides no evidence that the present tax structure has rendered the country's productive effort sluggish. On the contrary, output in the United Kingdom has been rising very rapidly and by far the larger part of the increase has been accounted for by the greater output per man. Industrial production in 1950 was about 40 per cent. higher than in 1946 and agricultural output also rose substantially. Output per man in industry has risen at a rate seldom or never experienced during the inter-war period.

4. Nor is it a fair criticism of the tax structure to say that it has hindered the expansion of production indirectly, by making it difficult for firms to re-equip and modernise their plant. The limiting factors on investment since the end of the war have been physical and not financial. Private industry has been willing to pay for considerably more new plant and building work than it has been able to obtain. Taxation cannot be said to have prevented industry from making full use of the resources the country has been able to devote to investment. (See also para. 25 and 26 below).

5. It is only if the relation between taxation and output is considered purely in terms of direct financial incentive that this combination of rapidly increasing production and stiff taxation appears paradoxical. Financial incentives are, of course, only one factor affecting the productive effort. Although high and progressive income taxes may in themselves tend to lessen the incentive to work (although their effect upon some people is to cause them to work harder or longer in order to obtain the

higher gross income which is necessary if they are to maintain their standard of living), the social and economic policies of which they form an essential part have been most effective in increasing output. Of these the most important contribution to high production has come from full employment. Not only is it essential to use the country's available manpower to the full in order to secure the greatest possible output, but conditions of full employment alone provide the atmosphere in which maximum individual effort can be expected from workers and managers. In conditions of severe unemployment many who would desire nothing more than a chance to work are denied it and their fellows hold back for fear of working themselves out of a job. Agreements to limit production multiply and restrictive practices flourish among employers and employed.

6. A greater equality, towards which re-distributive taxation has contributed so much, is perhaps the most important of all the factors making for full employment. Those who ask that their business should enjoy a combination of the high and stable demand of the "forties and fifties" and of the comparatively low taxation of the pre-war years, are demanding the impossible. The degree of progressiveness within the tax structure which has been established means that consumers' purchasing power is more widely spread than before the war. Since poorer people tend to save less of their incomes than those who are more well-to-do, this has raised the level of consumers' demand and also made it more stable. Thus, the increase in progressiveness is an important factor in forming the sort of economy in which full employment can be maintained, both when conditions are favourable and when they are adverse.

It is true, of course, that factors which decrease the likelihood of unemployment arising from shortage of demand, also make the problem of avoiding inflation more difficult. But a full employment policy necessarily involves creating a situation where there is a danger of inflation. Looking back to the inter-war years, the over-riding problem was that of unemployment arising from insufficient demand, and it would be over-anguine to imagine that this problem will not threaten us again. Experience has shown that demand can be more easily curtailed to avoid inflation than it can be stimulated to avoid unemployment. Moreover, it would be wrong to regard the degree of progressiveness of taxation as something which should necessarily fluctuate with the need to increase or decrease spending power in order to avoid unemployment or inflation as the case may be. It is bound to rest on the prevailing attitude as to what is consistent with social justice. It is the general level of taxation which should, and will, vary with the need to boost or restrain the purchasing power.

7. Has the achievement of a juster distribution of income over the last ten years, by lessening the material rewards for economic success, slowed down economic

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progress? In so far as a large part of the increased taxation on unearned higher incomes has hit incomes from inherited fortunes, it can have little deleterious effect on enterprise. But there remains the fact that the comparative financial rewards for success in industry and other spheres have been reduced. We do not consider, however, that this has produced any serious hindrance to individual effort, or led to a loss of talent to positions of responsibility. There are still considerable differences in the standard of life at the different stages on the industrial ladder or between the successful and unsuccessful in any profession or occupation. The desire for promotion and greater responsibility remains strong. One of the reasons for this is that the intangible elements of satisfaction and prestige are just as, or more, important incentives as financial success, in calling forth the spirit of invention and enterprise. In our view, a society in which the material rewards for success are so great that they are regarded as unjust, however equal the opportunities to secure them, will not provide the atmosphere in which the scarce gifts of outstanding men and women will be put to the best advantage. We regard as significant, even if a little exaggerated, the frequent complaint in certain sections of the press that a social stigma has become attached to substantial wealth and thus lessened the incentive to business success. Excessive financial incentives will be self-defeating in a social climate where they are (quite rightly) regarded as unjust.

8. The third principal objective which the tax structure makes it possible to achieve is the provision of social services which go a long way towards making available to every individual the essentials for a full life, in particular in the fields of education, housing, health and nutrition. Such a high level of expenditure on social services is made necessary because these basic needs can only be generally satisfied through social action. The increasing satisfaction of these needs is a vital factor in maintaining a vigorous economic and social system. The provision of greater educational opportunities, of improved health and social conditions generally, is an important contribution to increased productivity. For the rate of industrial progress to-day depends on the intelligence and awareness of every individual in the community.

9. We do not think the case can be substantiated that the increasingly egalitarian policies, of which the tax structure is an expression, have weakened the country's productive effort. On the contrary, we believe that it is only by such measures that a firm basis for economic expansion can be laid. This is not to deny the need, however, to scrutinise the existing structure critically in order to find means for improvement.

Corporate Taxation

10. Corporate taxation plays an important role in determining the amount of the proceeds from production which become purchasing power in the hands of individual shareholders as compared with individual wage earners and salary earners. In addition, just as income tax on earned income affects the economic behaviour of the individual employee, corporate taxation will affect the policy of the company. It seems to us, however, that current discussion on corporate taxation is only too frequently badly confused between the distributive and productive effects of the system.

11. The effects of corporate taxation may be divided between that on the purchasing power and personal wealth of the individual shareholders and the effect on the investing power and economic behaviour of the company. The wealth of the shareholders is dependent on the rate of taxation both on distributed and undistributed profits. The tax on distributed profits directly reduces the shareholders' current income from the company, and that on undistributed profits, his prospects of future income.

In the amounts that companies put to reserve of course account is taken of replacement needs and of their desire for development. The level of taxation on undistributed profits, by helping to determine the amount placed free to reserve, is a main factor in influencing industry's demand for new capital expenditure. Another is the amount of the initial tax-free depreciation allowance. Although over the whole life of an item of plant its original cost is allowed in tax-free depreciation allowances, the timing of these tax allowances, as determined by the magnitude of the initial allowance, affects the liquid position of the

firm and hence its willingness to undertake new investment. Therefore taxation of undistributed profits, and variations in the initial allowance for depreciation, provide a fiscal means of adjusting the demand.

12. *Profits Tax.*—The profits tax, despite its heavy discrimination against distributed profits, also falls upon retained profits, of course, and it is in this aspect of the tax which has attracted some of the sharpest criticism. There is no difference in principle between this tax and the levying of income tax at the standard rate upon company profits, and our remarks in this connection may be taken to apply to all aspects of the taxation of the retained profits of enterprise.

13. Here we are confronted with an apparent conflict between economic and social objectives. A major problem of a full employment economy is that of securing enough savings to make it possible for the savings-investment equation to be achieved without resort to inflation. Company savings make a direct contribution in this direction, and in recent years they have made the most important contribution. It might therefore be agreed that, from an economic point of view, so long as inflation and not deflation is the immediate danger, there is everything to be said for pushing them to the highest level possible, and that a tax which diminishes them is a bad tax, or at the very best, an indifferent tax, for it cannot do more than transfer money from one form of saving, company reserves, to another form of saving—the budget surplus.

14. But retained profits not only help to pay for the investment programme. They also swell the wealth of the shareholders to whom they belong. A policy of retaining taxation on retained profits to the extent of running down the budget surplus to nothing, and of depending on the consequent increase in corporate savings to provide disinflationary compensation, might (subject to certain exceptions which will be noted below) be neutral from an inflationary point of view, but it would certainly have a very sharply regressive distributive effect. The value of ordinary shares would increase overnight, and both the present capital wealth and the future income prospects of their owners would be raised considerably.

15. During the past 15 years the values of industrial ordinary shares have increased comparatively slowly. Even at the peak of this summer's boom their index number has only been 40·6 per cent. above the July 1935 base—an increase much less than in the price level and much less than that which has taken place in almost all other countries. To those who welcome the redistribution which has taken place in the past decade, this is naturally an important fact and one which they would be most loath to see disappear. Undoubtedly the high taxation of distributed profits, and other restraints which have been put upon their increase, have had much to do with it, but it would, in our view, be a mistake to imagine that the limitation by taxation of retained profits has not also been an important factor. Those who argue that Stock Exchange prices are overwhelmingly influenced by current dividend policies and hardly at all by the reserves and future prospects of a business, should remember the great fluctuation in market values which took place during 1949—a year of almost completely effective dividend limitation.

16. It is not of course suggested that the value of industrial equities can be influenced by anything other than a combination of present dividend policy and future dividend prospects, plus a small allowance for value on break-up—in the case of most public companies a contingency so utterly remote as to be of quite negligible importance. This raises the question of what would be our attitude to retained profits if an effective scheme of dividend limitation were to be put into operation. Would we then regard their reduction by taxation as wholly unjustifiable? The answer is no. In the first place, many schemes of dividend limitation would relate permitted increases in earnings, and would thus preserve a connection between retained profits and the income of the shareholder. In the second place there are very strong and obvious political reasons why no scheme of dividend limitation would be regarded by the Stock Exchange and by the general body of investors as a permanent scheme; and without permanence the divorce between reserves and share prices would not be achieved.

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17. Even if these difficulties could be overcome, however, the case in favour of the taxation of retained profits would still not collapse. A balance would still need to be struck between the incentive and the sense of independence which the ability to finance development schemes out of retained profits gives to the "managerial" company, and the inevitable lack of social control over investment so financed. Unless a building licence is involved, it is very difficult today to exercise any control over the direction or extent of such investment. Nor can the savings which are used in this way be regarded as always making a full distributive contribution. They often stimulate new investment to cancel out their own effect, and leave any inflationary gap which there may be as wide as it would have been if they had never existed. This would not be the case if they were drained off to swell the budget surplus. Furthermore, the capital expenditure to which they lead may sometimes be of a wasteful nature. These firms which have savings available and which choose to employ them, are not necessarily those able to undertake the most socially valuable investment projects.

18. We therefore feel that, even if the distributive implications of substantial remissions of tax on retained profits could be adequately dealt with, there would still be much to be said for not encouraging by fiscal means a great increase in the retained profits of enterprises. The main effect of doing this, in a situation in which the resources available for investment did not rise, would be to increase the share of that section over which it did; and we could not regard a development which might, for example, impede the electricity generating programme as desirable. This is not to say that, as investment resources increased, fiscal steps should not be taken to see that private industry was able to maintain its proportion of command over these resources. Indeed, one of the reasons why the profits tax on retained profits is regarded by us as a useful tax is that its level can be raised or lowered, without the more widespread and possibly unwanted effects which would follow from a change in the standard rate of income tax, according to whether the general economic position required that industrial investment be stimulated or damped down.

19. We put forward this point of view after considering the argument that in a full employment economy, corporate taxes largely fail in their purpose because they are treated as a cost by those in control of companies, and are in fact paid by the customers and not by the shareholders. The alternative would presumably be to levy all direct taxation upon individuals, and to hope to claw back (by either rates on unearned incomes—which, in itself, we favour—see Section 46 below) the revenue which would be lost. It is not clear to why such a scheme, even if fully practicable, would achieve its proclaimed aim. Directors would be just as likely to make their customers pay for increased dividend distributions to compensate their shareholders as for an increased tax on retained profits. A scheme of dividend limitation would meet this difficulty, but, in as far as it was introduced for the purpose of making remissions of retained profits unnecessary, would be inadequate for the reasons cited above.

20. In any event we cannot accept the view that increases in corporate taxation are automatically passed on to the consumer. We believe that substantial sectors of industry are too competitive for this to happen, and that many other sectors are subject to a price control which makes no allowance for such a "cost". We are unconvinced also that the normal company determines its pricing policy in such a way as to make it possible for accurate allowance to be made for an item such as profits tax. Nor does either the behaviour of profits, dividends and share values over the past 12 years, as a whole, or their behaviour in the periods immediately following changes in the level of profits tax, suggest that they are impervious to the incidence of corporate taxation. This is not to say that the consumer may not sometimes be called upon to pay some part of corporate taxation, but it is to say that this does not happen on a scale sufficient to make corporate taxation undesirable, or ineffective as a tool for controlling the wealth of the ordinary shareholder.

21. So far we have dealt with that part of the profits tax which falls upon retained profits. We now turn to the much more important part which falls upon distributed profits and to the differential between the two rates. The extent to which this differential encourages conservative

distribution policies is a matter of some dispute. It has been held that the decisions on dividend policy of most boards of directors are based largely on such factors as the legitimate expectation of their shareholders and the necessity of maintaining the company's ability to raise money in the capital market, and are hardly influenced at all by the rate of profits tax in operation. During a period when the climate of opinion is against dividend increases, as in 1949 for example, this is probably so. Provided the profits are these firms are very loath to reduce dividends and any increase in profits tax which may take place, even though nominally levied on distributed profits, will probably be paid out of undistributed profits, with the rate of dividend remaining steady. In a period when there is a generally upward movement in dividends, an increase of the differential, or even its existence, may well make the upward movement less pronounced than it would otherwise be. To believe otherwise is to take the view that directors not only regard the needs of their business for reserves as less important than the needs of their shareholders for dividends, but that they hardly even weigh the former consideration in the balance.

22. One aspect of the distributed profits tax in our view needs attention, not so much because it is inequitable as because it is undesirable in its consequences. This is the levying of the tax upon preference share dividends but not upon payments of loan interest. This arrangement does not weigh upon the holders of existing issues of preference shares, but it does provide a substantial deterrent to the issue of new preference shares. This is unfortunate, for preference shares present to industry the advantage of a form of capital which is almost as cheap as loan finance, but which does not put industry in a debtor position. Furthermore, preference shares are a form of security highly acceptable to financial institutions, particularly if they are redeemable within a fixed period, and this point is the more important in view of the replacement of the private investor by the financial institution as the chief source of industrial capital.

23. We therefore recommend that profits tax should not be levied on payments of dividend on preference share issues which do not carry participating rights, and that the revenue lost by this change should be made up by whatever small increase in the rate payable on ordinary dividends is necessary. It is already the ordinary shareholder who in fact pays the tax, even though it is nominally attributed to preference shareholders. This new arrangement would merely make him do so in a way which would not discriminate against preference shares as opposed to other fixed interest capital. The only practical upset which would result from the change would be a worsening in the market standing of those companies with little or no preference share capital, relative to those with a good deal. As the opening of a gap between these two types of company in recent years has been an entirely fortuitous effect of the profits tax, for which no good reason could be given, a reversal of the trend would help to correct a small injustice.

The "Depletion of Capital" Charge

24. The Royal Commission will no doubt wish to examine the allegation that the present system of company taxation is preventing industry from "maintaining its capital intact" at a time when prices are rising. Discussion of this matter is often vitiated by confusion between two different ideas. The first is that an individual firm, or industry as a whole, is not replacing its fixed assets as they wear out (or their stocks as they are sold), with the consequence that the physical capital of the firm, or industry as a whole, is declining. The second idea, which is to a large extent a separate one, is that companies are unable to maintain their physical capital intact in face of rising prices without recourse to new finance, so that the physical equivalent of their existing money capital is reduced.

25. As to the first issue it is clearly quite wrong to allege that the tax system is preventing industry from maintaining its physical capital intact, or even that high taxation is an effective limitation on expansion. The limitation is an effective limitation since the war have not lag factors on fixed investment since the war have not been financial. Companies have been willing to spend much more on investment than limitation of supplies has allowed. Building work has been limited by the licensing system and, despite this indirect control over expenditure

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on equipment, the demand for machinery has been in excess of the supplies available. Thus the amount of fixed investment in private industry has been held down by direct and indirect controls and shortages, not by any general limitation of the finance available to companies owing to the severity of corporate taxation. The further, and separate issue as to whether a sufficiently high proportion of the nation's resources have been devoted to fixed investment in private industry, is outside the scope of this enquiry. There seems, however, some need to make the obvious point that if more resources were to be put to this use, there would have been less available for investment by the nationalised industries, for exports or for personal consumption or government expenditure. So that any case for increasing private investment must also point the field where the corresponding reduction is to be obtained.

25. There seems no support for the allegation that excessive taxation or credit stringency has prevented firms from maintaining their working capital intact nor from increasing the volume of their stock as production increased. The estimates of the value of physical income in stocks and work in progress published in this year's National Income White Paper, show estimates of £300m., £215m. and £115m. in 1948, 1949 and 1950 respectively. Thus the volume of stocks in the whole economy has been rising and there is no reason to think that private industry has not shared in this increase.

27. The second possible meaning of the allegation—that companies cannot maintain their physical capital intact without fresh borrowing—is a quite distinct one from that just discussed. It involves a point of principle which occurs in connection with both fixed and working capital. In the first case the issue is whether tax-free depreciation allowances should be based on the original cost of equipment, or the replacement cost; in the second, it is whether the increases in value of stock due to increased prices, which when realised are regarded as trading profit for accounting purposes, should be treated as taxable income. Provision for tax allowance is at present only made for maintaining the initial sum of money spent on working capital, not for maintaining real capital. In the case of both the proper treatment of depreciation allowances and stock appreciation for taxation purposes, the issue is whether, when prices are rising, the company's taxable income should be reckoned after allowance for maintaining the original financial capital intact (as at present) or after allowance for the current cost of maintaining real capital intact.

28. In our opinion the present principle of allowing for the maintenance of financial capital intact for the purpose of estimating taxable income is the correct one. The issue is not the economic one of whether companies are actually in a financial position to undertake sufficient investment. As we have already stated there has, in the case of fixed investment, been excess demand in recent years in relation to the resources available, and we have seen no evidence to suggest that financial stringency has worked against the maintenance of adequate stocks. The issue involved is the more limited one of—what is fair financial treatment for companies and hence for ordinary shareholders. The question is whether a person who subscribes a certain sum to finance a company, should have a right, expressed by the treatment of the company's income for tax purposes, to expect the money value of his holding, and hence the income derived from it, to increase in step with rising prices. We do not think the tax system should be adjusted to give this compensation for rising prices as of right. All the various kinds of money income subject to taxation have their real value depressed by rising prices, and it would in our view be neither a suitable way of meeting the effects of rising prices, nor practicable, to assess taxation on them in terms of real income or real tax receipts allowing for rising prices. The Milford Tucker Committee made this point when discussing schemes for revaluing fixed assets, which they said, "involve giving preferential treatment to the owners of businesses as against other classes of taxpayer. The non-trader who saved a sum of money before the war and invested it in Government securities or other fixed interest bearing securities, finds that it is now worth, in terms of real value, a half or a third of what it was worth when he invested it, but he remains liable to tax on the full income from that and other

sources; he does not get, and would not be given within the framework of the existing Income Tax System, any allowance for the loss of capital or income. The pensioner who draws his pension from a superannuation fund to which he has contributed over his working life, may find that the real value of his pension is far less than the real value of the contributions that he and his employers have made."

29. Hence even in the case of unincorporated businesses we should not regard it as proper to offset the effect of rising prices by calculating depreciation allowances on a replacement cost basis (or removing the tax liability on stock appreciation). But in the case of companies, the fact that a substantial part of company finance is raised by debenture and preference stock further strengthens the case against such a course. For if the tax system is deliberately designed to enable companies to replace their physical assets at higher prices without raising new finance, the ordinary shareholders will benefit substantially from rising prices on this count alone. The money value of the physical assets and hence their earning power will rise with the price level, but debenture interest and preference dividend (where the full dividend is being paid) will remain constant in money terms so that the earnings available for distribution to ordinary shareholders will be increased by more than prices. This decreasing burden of fixed charges at times of rising prices is an offset for the ordinary shareholder against replacement difficulties. This is, indeed, widely acknowledged by implication, in that equities are regarded as the most suitable investment hedge against inflation. We do not regard the ordinary shareholder as unfairly penalised by rising prices, and we do not think that the tax system needs adjusting on this account.

30. In practice, we agree, a considerable part of the increase in cost of maintaining fixed and working capital intact is met out of taxed profits. But we see no objection in principle to this or to companies having to issue new shares or their borrowing from the banks, when the cost of capital goods or stock has risen.

If new money is raised by inviting subscriptions to new shares in order to meet the increased cost of replacement, it will mean that the physical equivalent of the original shares will be diminished. But such inability "to maintain capital intact" does not of course imply any decrease in actual physical capital as is often suggested. Similarly in the case of working capital, when prices are rising sharply, the increased finance necessary may in certain circumstances have to be obtained by increased borrowing. But that is no reason why the volume of working capital should decline. The dispute is really about the income that people derive from companies, and the value of their capital holdings, not the economic behaviour of companies and the amount of investment they undertake. This means that criticism of the present treatment of depreciation allowances and stock appreciation can only be sustained in terms of a demonstration that equity shareholders are unfairly treated as compared with the rest of the community, at a time of rising prices; and this has not and cannot be done.

Concessions to small companies

31. We recommend certain tax concessions for small companies which, in contrast to the large company, must rely almost exclusively on retained profits for their permanent capital. The reason for this is that most lending institutions consider such companies to be bad credit risks because:

(i) Their inability to raise permanent capital keeps them in a condition of having little to offer in the way of security; they rely on bank and trade credits to finance their business and they often economise in expenditure on business premises. Their net assets are consequently small and the bricks and mortar element in these assets may not be sufficiently solid to inspire confidence in the lender;

(ii) The cost to the lending institutions of investigating and negotiating the provision of permanent capital to a small company generally outweighs the return on the investment. Such investments are more costly in time and money than they are worth, even if the risk of loss is discounted. When this risk is taken into the lender's calculation, as it should be, the short average life of the small company must make the provision of permanent capital to-day a largely uncommercial transaction.

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The small company must, therefore, rely to a very large extent on its own profits to maintain or expand its fixed and working capital—in short to survive in the long run. We believe there are a number of good reasons for ensuring that a small company does in fact survive.

(a) A substantial part of British industry is at present in the hands of a great number of small concerns whose decline would cause a considerable amount of economic loss in the sense that organisation, know-how, special adaptation to particular markets, etc. would be dissipated and not necessarily replaced.

(b) The rise of small firms stimulates competition amongst the existing leaders of business, which without pressure from below might grow too comfortable, secure and unenterprising. It is certainly not the role for small firms to grow to any size, but this does happen sufficiently frequently to provide a reason for supporting the existence of the species.

(c) It may be true that it is not often that the small firm will come forward with a new idea or an enterprising commercial venture, but the fact that this happens occasionally justifies belief in the small firm as a necessary element in those forces which make for economic progress.

(d) There will remain a need for small units in industry. They are necessary in certain trades on the ground of economic efficiency, and elsewhere because of the psychological advantages of working in small groups, in order to harness the talents of those who will work best without any superior. The small company is likely in the future to become a more important representative of private industry, while the large private corporation has been tending to be replaced by public bodies.

32. We suggest, therefore, that in order to help the development of small companies, they should be treated more favourably than large ones in respect of depreciation allowances. Our suggestion is that small companies should, in normal times, receive larger tax-free initial allowances for expenditure on plant and machinery than larger firms. For example, the concession might apply to firms whose profits (as assessed for Income and Profits Tax before allowances for depreciation) were under £15,000 per annum. These would be allowed a 100 per cent. initial allowance on their first £3,000 expenditure on plant and machinery each year, say 66½ per cent. on the second £3,000, and then the remainder at the same rate as other companies (assuming these to be in the region of 20 to 40 per cent.). Marginal provision would have to be made for profits just over £15,000 to obviate a situation in which smaller profits before tax could mean larger profits net of tax.

33. Such a scheme seems an appropriate way to meet the difficulty in borrowing experienced by small firms. It is a proposal for deferring part of their tax payments as compared with other companies and they are thus in effect giving them an interest-free loan from the Revenue. We suggest that, when the general economic position makes possible the restoration of initial allowances, such a differential should be put into operation.

Taxing Capital Gains

34. The present system of Income and Profits Tax does not tax money made in the form of capital gains. We consider that it is unjust and undesirable that this form of making money should not be taxed while earned and unearned incomes are. It is incongruous that the money made by buying and selling securities, business and property, which may easily exceed an individual's other income, should escape, whilst his earned income (if any) is subject to heavy Income and Surtax. Perhaps it should be made clear that the case for such a tax does not rest on the idea that capital gains are necessarily a wrong or anti-social form of money-making, any more than the case for taxing income rests on the idea that incomes are wrong.

35. Such a tax could be assessed either on the increase in value of capital held by individuals whether realised or not, or solely on the capital gains actually realised. The advantage of the former alternative would be that the tax liability would not be affected by whether the investment were held or sold. There would not be the incentive, which arises when only realised gains are taxed, to hold

investments which were increasing in value while selling those which had faded worse, in order to reduce the tax liability. The tax liability in relation to the total gain in individual capital holdings would not, in the former alternative, vary according to whether the gain was realised (i.e. depend on subsequent switches), and this form of tax might therefore be regarded as more equitable. On the other hand, a tax levied solely on realised gains has the advantage that it falls on people when they are actually realising cash which they are likely to spend. It has thus a greater disincentive effect in restraining demand and is the more logical extension of the existing system of income taxation. There is, in addition, a very strong and probably overriding administrative case in favour of the latter alternative of taxing only realised gains, in that to do so would involve much less work in assessment. A tax on all gains would necessitate valuing the whole of an individual's capital holding every year, which in the case of business interests and property would be very laborious and might involve an expenditure of effort entirely out of proportion to the revenue raised. A tax on realised gains, however, could be assessed strictly on prices actually paid or obtained (with certain complications in the case of holdings in unincorporated business).

36. In determining suitable rates of taxation for realised capital gains two considerations, which are to some extent mutually opposed, have to be taken into account. In the case of gains which result from month to month purchases of stocks and shares, the profit derived can properly be regarded as akin to income and can appropriately be taxed at the same rates as other income. On the other hand, with gains which are obtained as a result of selling an investment which has been held for several years, another consideration becomes important, that is the obvious point that the tax hits a person if for some reason or other he wants to realise part of his holding, quite possibly to reinvest it, but not if he keeps it in the existing form. Thus such a high rate of tax as that levied on income would be too high for the taxation of long-term capital gains. If gains which are not realised are not to be taxed, then the rate of tax on those which are cannot be very high. But this objection can be greatly reduced by ruling that, when a person dies, his estate should be assessed for capital gains tax before being assessed for death duties. This would leave an incentive to people not to realise their capital gains by selling investments during their lifetime and thus have a restraining effect on expenditure out of capital, whilst at the same time prevent people from circumventing the tax by borrowing on the security of their investment sums that they would not have been able to obtain had their capital not appreciated.

37. We suggest that long term and short term gains should be treated separately as in the Federal gains tax in the U.S.A. There a long term gain is defined as a gain derived from assets held for more than six months. We think that a period of twelve months might be suitable. Short term gains could be added to income and taxed as such. Long term gains could be taxed at a separate rate. In each case provision would have to be made for offsetting losses against gains. The American provision is that losses can be set against gains plus \$1,000 of other income and that a net capital loss can be carried over into later years, but not beyond the fifth year after that in which the loss was incurred. In order to remove any incentive to realise capital losses so as to reduce the tax liability on ordinary income, we feel that there should be no provision for offsetting capital losses against ordinary income. As to the period during which losses can be carried over, we do not think that it should be as long as six years. The longer the period the less effective the tax becomes. If a period of raising capital values follows a period in which they have fallen, the offsetting provisions tend to result in people not having to pay on gains because of the losses they have previously made. This is only fair in the short run, but after a certain time has passed losses are accepted as something over and done with. Current gains are not then primarily regarded as a restoration of previous values and if realised may be spent as freely as if there had been no losses, say, three or four years ago. We therefore think that the offsetting period should be limited to three years, i.e. two successive years after the net loss was incurred.

38. The appropriate rate at which to levy tax on short term gains is the rate of Income and Surtax prevailing at the time. The rate of tax on long term gains should also

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be progressive, increasing with the size of the gain. Allowance must be made, however, for the time over which the gain has been made so that a single gain made over a period of, say, ten years should not be more heavily taxed than five separate gains spread over the same period with the same total. Thus the scale of progression should refer to the gain divided by the number of years over which it was made.

39. The actual scale of progression must depend to some extent on the circumstances at the time and the level of other income and capital taxes, but the kind of scale we have in mind might have three steps with rates of tax up to 10 per cent. on gains per year from £100 to £250; 30 per cent. from £250 to £1,000 and thereafter 50 per cent. All long term gains below £200 in absolute amount would be excluded.

40. Such a tax would be levied on gains realised from all forms of investment: stocks and shares, property and private business interests. In the first two cases a clearly definable price will have been paid for the investment upon which a gain is realised when it is sold, or if the investment was inherited it will have been valued when it changed hands. In the case of money obtained from selling an unincorporated business, it is difficult to determine the capital gain. It would not be altogether fair merely to deduct the cost of the original assets purchased. The owner's private savings would then theoretically be subject to capital gains tax if they were used to expand the business but not if they had been kept in the bank. The object of the tax is not to tax a growth in individual wealth resulting from an expansion of assets bought from savings, but only from a growth in value of existing assets. Such savings which have already been assessed for individual income tax and are ploughed back into unincorporated enterprises should in principle be deductible from the capital gain. To achieve this, "capital expenditure" by such businesses would have to be recorded. But in practice little distinction is made between small scale capital and current expenditure in small businesses, and expenditure which might strictly be regarded as capital and hence not deductible before Income Tax is assessed, is lumped in with current expenditure. Hence business improvements may be made out of untaxed earnings except in the case of purchase of larger assets such as new buildings and machines which it is perfectly practicable to record. The fact that these purchases may have been financed by bank advances and not out of savings does not affect the issue because when the business is sold such loans reduce the net worth and the net effect is the same. The capital gain on selling a private business is thus the sum realised less the original price together with recognisable capital expenditure.

41. It might seem at first sight that the taxation of capital gains realised from selling shares in companies leads to unfair double taxation of savings ploughed back into the business, an injustice which provision must be made to avoid in the case of unincorporated enterprises. This is not so. Undistributed profits used to purchase capital assets and hence increase the value of shareholders' investment in the company are not subject to individual taxation, but only to corporate taxation. It is only by a capital gains tax assessed on an individual basis, that companies' earnings saved in this way can be prevented from being passed on to the shareholder free from any personal taxation. Their subtraction first to corporate taxation in the form of Profits Tax and Income Tax on undistributed profits, and then to personal taxation of

capital gains, is more favourable treatment than that meted out to distributed profits which are subject first to distributed Profits Tax at a higher rate and then to Income and Surplus assessed on a personal basis. Indeed, the large individual shareholders would probably still pay considerably less tax on the money ultimately accruing to them in the form of long term capital gains than on currently distributed profits.

42. We think that capital gains on owner-occupied homes should be exempt from tax if the proceeds from selling the house are reinvested in another within five years. The owner will, in general, only sell his house in order to buy another. A capital gain on the sale of his existing house will probably be the result of a general rise in the price of houses so that his new house will be correspondingly more expensive. To tax the gain would unfairly penalise those who moved house and undesirably restrict people's mobility.

43. As to whether gains from betting or football pools should be included for assessment in such a capital gains tax, we have no strong views in principle. But it does seem quite impracticable administratively to determine such net winnings and assess their liability to taxation on a personal basis when accruing to thousands or hundreds of thousands of people. Taxation on such winnings should continue as at present to be levied at the source, and not on a personal basis.

44. To sum up, a tax on realised capital is a desirable and practicable extension of the existing system of income taxation. We suggest that net gains made on assets held for less than 12 months should be added to other income for the purpose of assessment for Income and Surplus. Long term gains should be assessed on a lower progressive scale based on the gain per year the asset has been held. Capital losses could be offset against capital gains but not other income, and net losses carried forward into two successive years. When they die people's estates should be assessed for capital gains before payment of Death Duties.

Separation of the Rate of Tax on Earned and Unearned Income.

45. Under the present Income Tax System, the distinction in the rates of tax between earned and unearned income is made by means of the earned income allowance, whereby 1/5 of earned income up to a limit of £2,000 is tax free. This particular mode of distinction has the psychological disadvantage of making the marginal rate of taxation on earned incomes appear higher than it actually is. Whereas the standard rate of tax on earned income is in effect 4/5ths of 9s. 6d. or 7s. 7d., it is widely regarded as 9s. 6d. Without any change in the actual tax the same effect would be obtained by abolishing the earned income allowance and instituting two separate standard rates of tax on earned and unearned incomes of 7s. 7d. and 9s. 6d. respectively. We recommend that this separation should be made and that the rates on earned and unearned incomes subsequently varied independently whenever this was thought appropriate. It seems to us in principle desirable that there should be distinctive rates of taxation on earned and unearned income, and that taxation on the former might be increased in certain circumstances without raising the earned income rate. Tax rates on small unearned incomes of old people should continue to have special treatment and pensions should be classed as earned income.

3.12.1951.

EXAMINATION OF WITNESSES

3516. Chairman: Mr. Austen Albu and Mr. Roy Jenkins, you are here to give evidence on behalf of the Fabian Society?—Mr. Albu: Yes.

3517. We are very much obliged to you for your paper which we have all read. There is one thing I would like to know: on the outside of my paper it is headed: "Evidence presented by a group of Fabians to the Royal Commission". How does that relate you to the society itself?—The society has no joint view. What happens on these occasions is that a group of members who are interested in a particular subject get together and present the evidence. The society accepts no corporate responsibility.

3518. But would it go this far, that your group were asked by the society to put forward views on this matter?—Yes.

3519. There are one or two things I would like your views on. A great deal of this is argumentative material, and I would like you to enlarge upon one thing in paragraph 4. You are dealing with the question whether expansion of production has been hindered by the present tax structure, and you say there: "The limiting factor on investment since the end of the war have been physical and not financial". I wonder if you could enlarge upon that, with any statistical material which you have

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down upon?—Mr. Jenkins: I am afraid we have not brought any statistical material to get in. The arguments which we would put in support of it, and which I think are mentioned in the paper, are that for instance it has been necessary to have a fairly strict system of building licences so far as factory extensions are concerned, because there have always been rather more firms who were anxious to undertake such building than it was possible to allow to be done, just because of the shortage of physical resources; and that the demand for investment goods of all sorts has been very heavy since the war. There has been no question of a surplus so far as industries producing investment goods were concerned, and all the indications are that companies in various ways have been able to get hold of quite enough money to pay for as much physical investment equipment as it was possible for them to lay their hands on.

1526 From your observation, and I quite appreciate it is very difficult to get statistics about this sort of thing, could one speak generally about industry in that way, or would one have to pay attention to the experiences of different industries?—Mr. Abu: I would say that the experience is not so much of different industries, as of companies of different sizes and with different company structures, possibly.

1521 I appreciate that there is that element in it too, that is to say, facilities available to the large and well-known companies are by no means the same as for the smaller company. You think that industries are so various that some have had different experiences than others in their financial affairs?—That is possibly the case, but I would not have thought the extent to which it interferes with the general argument either on economic grounds or grounds of equity which we have put forward in this memorandum . . .

1522 I have got in mind that the initial allowance, which apparently was invented to some extent to aid the financial possibility of re-investment, was raised in 1949, if I remember rightly, from 20 per cent. to 40 per cent. Is not that possibly an indication that at any rate some parts of the industrial world were feeling the necessity of further assistance financially?—Of course, we strongly support the recommendations of the committee under Mr. Milford Tucker for a variation in the initial allowances according to varying needs and according to the varying economic conditions. I would have thought that our argument to some extent was strengthened by the necessity at the present time for more stringent credit control to restrict investment in the interests of both rearmament and the export trade.

1523 Why I mentioned the doubling of the initial allowance in 1949 was that it might be said to suggest that there was some financial difficulty on the part of industry, or parts of industry, that had to be recognised even at that time.—Mr. Jenkins: I think it might have been argued that in the circumstances of 1949, which was after all a year, so far as the world generally was concerned, of mild recession, we were moving into a period in which there might be a danger that the conditions which had applied, in which the demand from industry was greater than the resources available, might be changing over in the other direction, but the fact remains that if that was so the step of doubling the initial allowances was sufficient, because so far as one can tell there was no surplus capacity at all developed in the investment goods industries. And owing to the changes which had taken place since 1949 we have certainly swung back to a position in which the whole emphasis is on restricting credit available to industry, rather than the reverse.

1524 Of course, you gentlemen had the opportunity in 1949 of hearing the doubling of the initial allowance debated in Parliament?—Yes.

1525 Do you recollect what reasons were given?—My recollection is that it was put forward by Sir Stafford Cripps as being an attempt to meet the sort of criticism which had been put forward by industry, which has been put forward, for instance, by published memoranda from the Federation of British Industries to your Commission, that industries were not being treated favourably enough. Here, he said, was the token of help which may or may

not have been necessary in the circumstances, but the indications are at any rate it was quite sufficient for what was needed.

1526 The other thing that struck me on this point, which is I think an important one, was this: should one distinguish between the future requirements of industry for simple finance, and what the experience has been from 1945 up to the date which you are dealing with in your paper? One has got to recognise, of course, that there has been a very great demand on finance to carry volumes of stocks, not necessarily increased but at higher prices, and some industries no doubt are facing a very heavy replacement programme in terms of higher costs over periods of years ahead. Would your observation as to what has happened between 1945 and, let us say, 1950, be equally valid, do you think, for future years?—It is very difficult, I think, to predict what is going to happen in the future, except on the basis of what has happened in the past, and it would certainly be our view that the case that industry has not been able to re-equip itself has not been proved in the last seven years.

1527 I quite see your point on that. I wanted to get help from you as to what one could forecast about the future.—Mr. Abu: May I just add one thing? In this paragraph 3, where we say there is no evidence that the present tax structure has rendered the country's productive effort sluggish, of course we do include the initial allowance provisions, which after all are a part of the present tax structure, in fact they are included in the Income Tax Act, and only just removed by one paragraph and could easily be replaced. I think we would be strongly of the view that if they were necessary they should be restored.—Mr. Jenkins: I wonder if I may just ask for a point of explanation, that is, whether you were thinking primarily in terms of difficulty of replacement of current assets at greatly enhanced prices, or the difficulty of building up fixed capital in the future?

1528 I was thinking of the strain, or possible strain, upon the financial structure of the concern that had to face both the requirements over the coming years, because from its point of view it would be difficult to isolate the effect. Both call for increased funds being available.—Yes. Obviously the continuance of conditions, so far as the prices of stocks were concerned, which prevailed in 1951, of prices increasing as rapidly as that, would put an immensely heavy burden on companies' finance if that were going to continue, but I should have thought the indications were that you were not going to get a repetition of 1951 conditions, and that they would be corrected a little in so far as prices are now falling. In so far as fixed assets were concerned, I would have thought there were not indications that there was going to be any drastic changes from the position as it has prevailed over the last five years, though it may be of course that as the effect of egalitarian taxation measures become more and more felt it would be increasingly difficult to raise money from private investors, and I think we would take the view that over the long term there probably will be a fairly substantial increase in various public or semi-public means of raising finance.

1529 One thing I had in mind; I think you both say you think the scheme of initial allowances is a satisfactory tax instrument for coping with this sort of problem, would you favour some scheme for discriminating between various industries in the measure of assistance that initial allowances gave them?—Mr. Abu: I realise the difficulties, but I think I would, and I think they can be overcome.

1530 The difficulties being that no doubt if you left it on the floor of Parliament there would be a great deal of pressure, naturally, in favour of different industries, but if you get away from Parliamentary control, in effect you would then have a somewhat anomalous position?—Yes, I would hope that the debate on the floor of Parliament would take place on the grounds of economic necessity. I believe that the Government must have some responsibility for the necessary changes in the structure of industry in the future, particularly in the interest of experts, and so on, and this might very well be one of the weapons which they would use.

1531 If you had the matter left, for final decision, at any rate, in the hands of Parliament and an advisory body to advise them, there would be nothing particularly

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absent about that would there?—I do not think so. I realise, of course, that the Commissioners of Inland Revenue do not like to have to make this sort of discrimination, but I think it could be done, especially with an advisory body, as you suggest.

3532. There is one point where you are dealing with profits tax, paragraph 12, I do not know whether you could say anything more about it. You are referring to the fact that there has been, no doubt, a great deal of widespread criticism of the method of the tax. You say: "There is no difference in principle between this tax and the levying of income tax at the standard rate upon company profits". Is it not a difference in principle that the income tax levied at the standard rate is at any rate to a large extent handed on by the company to the various sections of proprietors, the debenture holder, the various classes of shareholder, whereas the profits tax is strictly a corporate tax which is not shared out again among the shareholders?—*Mr. Jenkins:* I think we were dealing there with the profits tax and the income tax at the standard rate upon undistributed profits, not upon distributed profits. Therefore I do not think the point about its being passed on to the various classes of proprietors does quite apply.

3533. Yes, I follow; if you confine it to undistributed profits at that point there is no difference. But have you considered this? I think you say somewhere that profits tax is strictly a corporate tax; income tax in so far as it is passed on is not, it is a half and half thing; do you think it satisfactory to have one kind of tax on a company's profits that is a corporate tax, and one kind of tax that is not?—I think it may be in some ways a rather anomalous position, yes. Although there may be a very sharp legal distinction between a tax which is a corporate tax and one which is not, one would have thought that at any rate to some extent companies were bound to treat the two sorts of taxes in their calculation in the same sort of way, because, for instance, in determining how much, with a given level of profits, a company should distribute it is no doubt bound to have in mind not only its obligations to its shareholders but also its need to build up reserves, and its need to finance certain schemes of development which it is considering. Of course to that extent profits tax and the rate at which it stands is a tax which can be attributed to a given amount of distribution just as directly, from an arithmetical point of view, even though not perhaps from a legal point of view, as can the income tax, and I would have thought companies took that into account in determining their distribution policy.

3534. I was rather struck by your project about special treatment of small companies, that is, paragraphs 31 to 33 in your memorandum; it is awkwardly directed to the difficulty of the small concern finding outside finance readily, is it not?—Yes.

3535. And if you maintain a heavy level of tax, year by year, on the profits that it makes, it probably will not be able to finance itself. But it would be rather a blind test, simply to go by what would be the net resources of the company, to distinguish it from the large company, would it not?—*Mr. Albu:* I admit that this wants a good deal of working out, and it may be that the best way to do it is simply to apply the initial allowance to the first profits of any company, on the grounds that the amounts that will be allowed will be a mere bagatelle for a company of any size, but that of course is a matter for the Treasury. In my own view, and I think some of my friends, there is in fact almost a difference in equity, I am not using the word in the technical sense, between the claims of the small company and the claims of the established public company, but in addition to the arguments we have put in (i) and (ii) of paragraph 31 and the subsequent arguments in the rest of the paragraph, the profits received by the small company are a much more direct incentive to those who manage the company than is the case in the large public company. It really would be justified to try to make some difference, because of the qualitative difference between the two types of company.

3536. Yes, but if you just go by the test of size, you really have not got any test of the social utility of the company's activities at all, or its efficiency, have you?—No. Of course, if one were dealing with the suggestion for variable initial allowances one could then bring in the other test which we were discussing before.

3537. I have two questions on capital gains, which is obviously a very argumentative subject. Can you tell me this, if you have been interested in the theory of it, do you consider that on each occasion when a man realises one of his assets at more than its historical cost, the gain is adding to his income?—*Mr. Jenkins:* Adding to his income in the sense of the money which he will spend during the coming year? If the question is that, of course the answer is obviously not, because it could not possibly be argued that the whole of realised capital gains were automatically spent as income. If the question is the rather less sweeping one of increasing the amount of money which he might in some cases treat as income for the year, then I think the answer would be "yes."

3538. Even without regard to the total improvement or "dis-improvement" of his position in the year?—*Mr. Albu:* You mean the total including the unrealised asset?

3539. Yes.—*Mr. Jenkins:* I agree that if one is going to tax capital gains on the basis of taking realised gains and setting off against them only realised losses, then the position is not entirely satisfactory. But of course one is then driven up against the only two alternatives of either doing nothing about capital gains, which obviously are a substantial source of spendable income in certain monetary conditions, or alternatively of going in for what seems to us the cumbersome process of valuing each year everybody's assets and levying the tax upon the change in their net position, whether realised or not. That seems to us more desirable but impracticable. Therefore one is almost bound to make the assumption, possibly not an entirely good assumption, that a man realises a fair cross-section of his gains and his losses.

3540. One more question, again on capital gains, on paragraph 42, the owner-occupied house. Do you make a concession to the owner-occupier of the house, who buys another house, out of sympathy to him or is there some theoretical distinction between his position and that of other people?—I think so far as houses are concerned it is the case, more than with most assets, that it is only very unusually that one disposes of one without acquiring another. Therefore there is a very direct relation between the new purchase and the sale which has just taken place. Secondly, there is the point that it would be obviously undesirable to discourage the mobility of people in moving about from one job to another, and from one part of the country to another, which would certainly be involved in levying capital gains tax on house sales without such a concession.

3541. The same thing is true of a change of investment, is it not? A fall in the rate of money might have given a man a profit on his investment as against what he paid for it, but if he is going to re-invest and make the same income, the capital gains tax takes a bit off.—*Mr. Albu:* Yes, it is a point. This particular thing is really a matter of rather rough justice.

3542. *Chairman:* I thought that probably was the case. Thank you.

3543. *Mr. Keldor:* What would you say were the main economic effects of heavy taxation of retained profits? You know the various suggestions made in this direction and I just wanted to have your views.—I thought it was quite clear that the liquid assets of companies are less than they would otherwise have been. I do not think, as we say in this memorandum, it has had much effect on the actual physical investment or on the expansion. It may have had some effect, but we do not think it has had any serious or deleterious effect on the distribution of resources. But of course it has reduced liquid assets, therefore it may in the future make it more difficult for companies to expand out of their retained profits, and it has also made it more easy for the Government to control the rate of investment in new physical assets, or the rate of expansion, as, for instance, at the present time. I think there is a great deal of exaggeration. If I might refer to some figures that I put in a letter to "The Times" in reply to the very interesting study by the F.B.I.* on the effects of inflation on industrial capital resources, as far as I could see, at any rate as things were going at that time, the actual amounts kept in company reserves were quite adequate to maintain their assets, and even maintain

* This memorandum will be reproduced in the Minutes of Evidence of the Seventeenth Day, 1st Aug., 1952.

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a small measure of expansion. But of course that is not entirely taking into account the replacement of assets during the war period, the period from 1939 to 1945, when of course company reserves were frustrated and could not be spent, and there was a very considerable inflation. If one takes the history since that time, then, even after taxation, the amounts that companies have been able to retain have certainly been ample to cover both the replacement of fixed assets at increased prices, and also the replacement and enlargement of stocks.—Mr. Jenkins: May I add a word upon that? I think if one accepts, at any rate for the purpose of argument at this stage, our point that physical shortage rather than financial shortage has limited total investment, then obviously the effect of having a much lower rate of tax on retained profits of companies during recent years would not have been to increase the total investment but would have been, I should have thought, in two main respects to change the direction of that investment. In the first place, it means that companies would have been able to do more out of their own resources, and would have had to go to the market for a smaller proportion of their money. From that I think two things follow: first of all, that there would have been rather less public control over the direction of investment, because it is far more difficult for the Government to control what a company does with its own money than it is for it to control the purposes for which it is raising new money; secondly, I would have thought that had there been lower taxation on retained profits, small companies might have been able to obtain a rather larger share of the total resources going, just because it is difficult for small companies to get outside money; I think we give three or four reasons for that in the memorandum, but I think it is a generally accepted point, that it is more difficult for small companies to get outside money. Therefore a danger in forcing companies too much not to expand out of their own resources is that you may benefit the large companies as opposed to the small companies. Partly with that in mind we made recommendations for special compensating concessions to small companies.

3544. If I may sum up your views, you would say that if public saving by the Government and corporate saving by the companies are to be treated as alternatives, you would in general prefer larger public saving and a smaller private saving; a higher taxation and a larger budgetary surplus, in which through financial channels the funds are lent out to industry, rather than that firms should make their savings themselves. That would be the first point. As against that, you would argue that this system strengthens monopoly and weakens the forces of competition?—There is a tendency in that direction.

3545. Because it makes it so much more difficult for small companies to threaten established concerns by their growth. And you think that if one could devise some system by which the smaller companies would not be hampered in their growth through the heavy taxation of profits, that would be the ideal solution to this problem?—Mr. ALBU: Yes, I think that fairly sums up the views put forward in this memorandum.

3546. In so far as the level of investment in industry could be increased, or would have to be stimulated, your view is that one would have to rely on initial allowances or on general monetary policy to secure this?—I think there are really two things here, there are questions of principle and questions of machinery. On questions of principle I think I agree, but we have not of course dealt with, nor I imagine is it within the terms of reference of this Commission to deal with, the questions of machinery for finance, which is increasingly becoming institutionalised and not by private investment. But I think in general we agree with the principle which Mr. Kaldor has put forward, although of course our arguments are not only based on grounds of economic policy; as you will see, as our memoranda they are also based on questions of justice as between taxpayers, and of course we would like to make this point very clearly, it is quite impossible to deal with the one without affecting the other. There is no way by which one can improve, even if it were desirable on economic grounds, the economic position of companies without giving greater advantages to equity shareholders, much above what we consider are justified either by the risk they take or any other ground, over those of

other taxpayers. Those I think are very relevant arguments for this Commission. The arguments were put very well, I think, in the report under the chairmanship of Mr. Millard Tucker, and we entirely support that.—Mr. Jenkins: I think at the same time we would not say that one should rely exclusively and entirely upon initial allowances and monetary policy in the sense that that might be taken permanently to exclude any remission of profits tax. Certainly at one point in the memorandum we do make the point that profits tax as distinct from income tax has a certain value, and that it might be varied up and down according to different trade conditions without affecting the level upon taxpayers as individuals.

3547. In any case, my point was that you do not think that, apart from initial allowances, there is any case for raising depreciation allowances or granting replacement costs as a means of stimulating investment in industry? In so far as that is a question of economic policy, initial allowances are a perfectly adequate weapon for this purpose?—Mr. ALBU: If you are going to ask us questions about depreciation allowances and the method of valuing assets, this is a matter in which the object (of revaluing assets) is very much complicated. The object that is frequently put forward is to show the true economic position on the company, but of course its immediate effect would be greatly to reduce the taxation paid by the company, and of course one cannot separate these two. I should have thought myself that the directors of any intelligent company, when examining their balance sheet (in fact they probably produce more than one balance sheet for the purpose) take full account of the fact that the value of their assets for taxation purposes is not their true economic value; but, of course, to make any change is directly to give that advantage to the ordinary shareholders in the company which no other saver gets, in an age of rising prices or inflation, and there is no way in which you can get over that. If you revalue the assets of a company for this purpose, while leaving everybody else's assets where they were before, of course you do in money terms give the ordinary shareholders an enormous appreciation of their investment.

3548. When talking about this point, supposing one had to give the ordinary shareholder an advantage, I am not saying one does but supposing that were the case, on general economic grounds, you do not think there is some other way of securing justice between taxpayers? For example, there is a suggestion to tax capital gains; would not that be a way of offsetting the advantage which shareholders would get from any lower taxation of business profits?—That may very well be so, and I do not think on grounds of principle we should oppose any alteration which left the position of the equity shareholder the same as it is to-day, or so better. But these are matters really which I think neither of us is fully competent to discuss. If you bring it down to that level, then I think they are entirely matters for accountants and perhaps economists. I can understand that the economists would prefer to see the accountants treating their figures in a way which the economist could more easily interpret, but I have not yet seen, nor has anybody put forward, any method by which this could be done without in fact, as I said, giving to the ordinary shareholder an advantage which I do not think is justified by the position he plays in most of these companies at the present time.

3549. I am sorry to go back on this, but you would agree that the advantage to ordinary shareholders of an increase in the net profit retained in the business must take the form of an appreciation in the value of his shares, sooner or later, but if some way could be found of taxing such appreciation that would be one way of meeting the difficulty, would it not?—Yes, I do not think this is a matter on which we have very strong feelings; in principle, if you put it that way, but for myself I in principle, if far the easiest way is to prevent the undue appreciation by far the easiest way is to prevent the undue appreciation of ordinary shares, rather than to tax the gain, which are made by that appreciation.—Mr. Jenkins: The principal point which I think we want to make on this section is that the argument in favour of adopting this section is that the argument to historic costs is, in our replacement costs as opposed to more with the dis-view, something which is concerned more with the distribution of income and wealth than the economic effects upon companies. Certainly, given a fixed overall total of investment, that is so, and we think it is important that the question should be approached from that point of view, as in our view is not normally done. Once

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that it is understood, that it is very largely a distributive dispute, and that the adoption of replacement costs instead of historic costs could only be justified by showing that in a period of rising prices the ordinary shareholder did worse than the general run of taxpayers, which I think has certainly not been shown. Once it is accepted that had to be done, then I do not think we necessarily say that it was essential that the present system should be maintained in all circumstances. Provided that point was appreciated, and provided, as Mr. Kaldor has suggested, that other methods might be explored of allowing a change in the method of calculating depreciation allowances, without greatly benefiting the position of the ordinary shareholder, we certainly would not object to it.

3550. From what you said to the Chairman just now, and also in your memorandum, I gather the impression that you regard a capital gains tax as a necessary addition to our tax system, from an equity point of view, but rather as a sort of second best?—Mr. ALBU: That certainly is my view.—Mr. JENKINS: It is certainly mine, too, that a capital gains tax has many disadvantages, but that it does seem necessary in a fair system of taxation that one should try and deal with the total amount of money which an individual has available for spending.

3551. So if some other method could be found of dealing with this problem, such as taxing people on what they spend, you would not be in favour of a capital gains tax as such?—Mr. ALBU: We should certainly want to examine the alternative proposal rather closely, but certainly on principle I am not against anything which achieves the same objective.—Mr. JENKINS: No, indeed, we certainly would not regard the spending of capital gains as being in any way more reprehensible than spending a store of capital, perhaps even rather less.

3552. Mr. CRICK: This is a very closely reasoned paper, and I hope you will forgive me if I am not seized of all the implications of everything you say. In your first paragraph you speak of those particular items of economic and social policy which, in your judgment, are relevant to the problem of taxation, and then if you turn to paragraph 6 you make a remark on taxation in relation to the general problems of inflation and deflation, boom and depression, and so forth. What I wanted to ask you was this: are we to infer that in relation to those particular objects you have mentioned in paragraph 1 you are thinking of the detailed application of the various taxes, whereas at the end of paragraph 6 you are thinking of the total structure of the budget? Would that be a fair interpretation of what you have in mind?—I think that is so, yes, in the sense that we are making the point, at the end of paragraph 6, that obviously the size of the income side of the budget in relation to the expenditure side can be varied according to the general economic conditions which are prevailing in the country; in other words, you need a higher surplus in certain circumstances than in others, and in other circumstances you may need a deficit, but we would not regard it as right that according to fluctuating trade conditions you should change the whole basis of taxation in the sense that as soon as you got into an incipient slump, you should make your taxation system much less progressive.

3553. The difficulty I have in appreciating that argument is that after all the total burden of taxation or, in your phrase, the general level of taxation, is nothing more than the aggregate of the details of every individual tax, and one cannot, as I see it, alter the general level without doing something to the detailed imposition of the taxes.—Mr. ALBU: I think that is true, but of course there are a wide variety of taxes so that it is not possible, I should have thought, to make reductions in the general level without making any great alteration in its distribution.

3554. But you cannot, can you, apply a policy directed to the general purpose of stabilising the purchasing power of the currency without doing something to the incidence of individual taxes. Therefore whatever you do in the prosecution of a monetary policy, if I may call it that, will have some effect on the distribution of the burden of taxation?—Yes.

3555. So that your purpose of stabilisation is inextricably bound up with your whole detailed policy with regard to the structure of industry, and the re-equipment of industry and the distribution of personal incomes, and so forth?—Mr. JENKINS: Yes, I think that is certainly so. Perhaps I can try and put the point like this, that at the present time one obviously has a very high total of taxation, partly

because of the policy of the budget surplus which has been pursued. If one were to get into a position in which one could substantially reduce the total, because one decided to have a fairly substantial deficit instead of a surplus, that obviously would involve changes in the rates of a great number of taxes, but one would then come up against the point as to what was to be one's priority in reduction, whether one was going, for instance, to reduce first those strictly progressive rates of tax which have played the most part, from the re-distributive point of view, and I think our point would be that while there might be some general reduction in those circumstances one should not give a high priority to reduce the taxes which have played the biggest part from the re-distributive point of view.

3556. To go one step from that, I suppose one could conceive of circumstances, say in a time of depression, when one would want to examine the question whether it would be more effective to ease taxation upon personal incomes or more effective to ease taxation upon business profits in order to encourage capital expenditure. You would agree that that choice might perhaps arise, in a time of depression, and would have to be examined from an economic point of view? In circumstances like this, and here I am coming very close to a question the Chairman put to you, would it not be an advantage to have a single tax on corporate profits, apart from the whole system of personal taxation?—In order that it may be varied without any effect upon personal taxation?

3557. Yes.—I entirely accept the point that the present position is illogical. I would not have thought it possible, at any rate not in the near future, to get into circumstances where the belt of profits tax was not sufficiently wide to give one a cushion for reducing company taxation without having to go down to cutting the standard rate as well.

3558. Cannot you see some virtue in simplicity?—Yes, indeed.

3559. There is something in that from the point of view of the pursuit of a very deliberate and calculated policy. There was a question I wanted to raise on your paragraph 4, which deals with replacement, and as it stands is concerned wholly with fixed assets. Your observation in that paragraph 4 applies both to provision of new plant and to building. Would you be inclined to say that it applies with any different degree of accuracy to those two elements, plant and building?—Mr. ALBU: I would not have thought so, in recent years at any rate. It may very well do so at some other time, but I should have thought the limitations on both building and the supply of plant, especially in view of the necessity for exports, and so on, had in recent years been almost of equal weight, but I must admit I have not actual figures.

3560. You are of course very well aware that the criticism of the weight of taxation in this direction proceeds along two lines, in relation to fixed capital on the one hand and stocks on the other hand. Is there any comparable reply that you would be disposed to make to the suggestion that the weight of taxation has borne heavily upon the capacity of companies to maintain their stocks at an appropriate level having regard to the current level of prices?—Mr. JENKINS: Not, I think, if one is dealing with the matter in physical terms, as in the first instance they do. Even when one had stock prices rising as sharply as they did in 1951, while that may have made nonsense of companies' profits, I do not think there is any evidence at all that it forced them to run down their stocks.

3561. Then you would not feel that there was any great distinction to be noted between the position of companies which require very large fixed capital assets and the position of companies which require to carry very large stocks and have comparative small amounts of fixed assets?—Mr. ALBU: I should have thought that was a very difficult question, because it of course really depends on the trend of costs and prices of fixed assets and raw materials, commodities. We have had a rather unusual period, in the last year or so, of commodity prices, and I think to base any taxation policy on that period would be extremely dangerous. I should have thought that in more normal times the trends are parallel or at any rate comparable, and that therefore there is no necessity to have a different approach. I would have thought also with regard to raw material it was easier to get short term

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finance to cover purchases at times when there were very rapidly changing prices, which again is a matter to some extent of Government credit policy.

3562. You do of course recognise that experience can vary tremendously from company to company? You would agree with that, would you not?—Certainly.

3563. And it is indeed on that ground, I imagine, that you have just expressed yourself as being favourable to differentiation of initial allowances. One of the differences which was specifically proposed in your paper is designed to help the small company, however one may define "small". But the practical suggestion you make in respect of initial allowances is of course impossible to adopt at a time when initial allowances have been suspended. Have you any other idea in your mind, within the field of profits taxation, which would serve the same purpose as the actual suggestion you make, the purpose namely of favouring the financing of development on the part of small undertakings?—I personally would not be against some actual direct relief of the taxation for the small company.

3564. In what particular form? Have you in mind some limited steps of graduation of profits tax on undistributed profits?—Something of that sort I would certainly be in favour of.

3565. There were one or two questions I wanted to ask you on capital gains and gambling. On capital gains only there is one question: have you considered the possible magnitude of the yield of the proposal you have in mind?—Mr. Jenkins: Obviously the yield would vary enormously according to the monetary conditions which were prevailing in particular years, but we did study United States' experience on this point, where again the yield varied very substantially, but in most years was appreciable, amounting I think to about 5 per cent. of the yield which came from income taxes. I think I should say that our primary interest in a capital gains tax would not be a yield point of view. In the first place, I think it would be dangerous for a Chancellor to treat a capital gains tax as being wholly or even largely a tax which would reduce the amount of money available for consumption, as obviously to some extent it would be a capital tax in the sense that the money, if not taxed, would not have been spent. Therefore our primary interest would not be from the yield point of view.

3566. You agree that the yield would be highly irregular, in fact in some years it might be negative?—Yes.

3567. Would you agree that it is not only irregular but extraordinarily difficult to estimate from year to year, even at the time of the budget for the immediate year?—It is a yield which is fairly directly within the control of the Government, of course, in so far as I should have thought much the biggest factor affecting it was the monetary policy of the Government.

3568. On the whole, would you agree, as a matter of principle, that a tax which is highly irregular in yield and highly difficult to estimate was a bad tax? Adam Smith thought so, and I wondered if you thought so?—Mr. Albu: I think we have already made it clear we consider it a sort of lesser evil.

3569. In your remarks on gambling, in paragraph 43, you come to the conclusion that it would be better, more convenient and more appropriate, to tax such winnings at the source, rather than on a personal basis. You come to that conclusion notwithstanding one factor which I have no doubt is clear to you, that taxation of winnings in that form is non-progressive, is it not? Does it strike you as acceptable that one should, for instance, tax at precisely the same rate the £5 which a man wins on the Derby and the £50,000 that he wins on a pool?—I think in this case we gave up in the face of the administrative difficulties.

3570. Only one other point: a good deal has been said about what one might call the increasing resort to institutional investment. I think at one stage your words were "public or semi-public bodies providing capital in place of the private investor". Whether you encourage that or not, it is I believe a fact, is it not, that that is taking place?—I should have thought very much so, yes.

3571. You would attribute that, I imagine, partly to the burden of company taxation and partly to the burden of personal taxation?—I should think up to now it is the

burden of personal taxation. I should have thought that the really radical redistribution of income which has taken place in the last 30 or 40 years has been a large factor.

3572. If one thinks solely in terms of the private investor, do you regard that as a healthy development?—Yes, I think I do, in general.—Mr. Jenkins: I think I would say that it is a development which would not seriously disturb us, and which is an inevitable development unless one is going to turn the clock back on the redistribution of wealth to a far greater extent than I should think any political party would want to do.

3573. Does it suggest to you the likelihood of increasing concentration of financial control of industry?—It depends of course on the methods of finance which are adopted. If you are dealing with finance houses whose aim is to secure control of as large a number of companies as possible, then obviously there is a certain danger there. If you are dealing with various bodies whose aim is not to secure control but only to help companies which it seems reasonable and desirable to help, then I should not have thought that amounted to a great concentration of control.—Mr. Albu: I should not have thought, in regard at any rate to that very large sector of the economy which is in the hands of quite large public companies, it would have made a very great deal of difference, because I should have thought the control over those companies was pretty concentrated already. I cannot see any sign that there is going to be a reversal of private investment which will bring back the ordinary private shareholder in any really responsible position in these companies, therefore I would not have thought it would make very much difference.

3574. Mr. Carrington: Are your proposals for small businesses limited to companies, or do you visualise them being applicable also to sole traders and partnerships?—Of course, on the question of initial allowances, and so on, I think we were considering mostly companies. I should have thought almost any enterprise which is going to grow at all in to-day a private company. We are considering growth; that is what we are concerned with.

3575. Quite a lot of business is carried on by partnerships, is it not?—We are concerned, as I say, with growth. I have no evidence of this, but I would not have thought there were many partnerships which intended to grow very rapidly, and the proposals we made are of course made on economic grounds and grounds of necessity for the growth of new companies and the continual stream of companies, some of which may grow to considerable size. I would not have thought sole traders or partnerships came very much into that field.

3576. Is it not the usual course for a partnership to be formed and then when it has reached a certain size the partners form a private limited company and it develops from that stage? Is that not the general path of development?—I have no personal experience of that.

3577. In your answers to questions about the effect of high taxation I gathered that you implied that the high taxation which we have had for the last five years or so has not had the effect of making it difficult for companies to maintain the physical volume of their stock?—Yes.

3578. Is that so? I suggest to you that very many companies have had to borrow money in order to maintain their stock positions, and in some instances to maintain the physical volume of their fixed assets.—Mr. Jenkins: Of course, there you do get the confusion of two different points which we did attempt to point out in the paper. It does seem to us that there is a complete distinction between the argument about whether or not companies have maintained, in physical terms, either their fixed assets or their stocks—we submit that they have been able to do so—and the secondary argument of what financial arrangements they have had to make. I would certainly agree that as a result of high taxation they have had to make that as a result of high taxation they are less favourable to the financial arrangements which would otherwise have been done, but shareholders than they would otherwise have done, but that is a distributive rather than an economic and productive point.

3579. In other words, they have had to borrow money to maintain their position?—They may in certain cases have had to do so, yes.

3580. Would you not say that there have been very many issues of short term notes and unsecured loan stock, and the like, during the last four or five years which

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have had to be made?—Yes. There has also, of course, been a substantial increase in the physical volume of stocks during that period, and while in the case of certain individual companies they may have been borrowing to maintain their position, I would not say over the whole field it was borrowing to maintain as opposed to borrowing to expand.

3581. Would you say that there had been an increase in the physical volume of stock as compared with the pre-war position?—No. I did not make that point, but you were specifically, I thought, referring to short term loans which had been floated in recent years, and those were not made necessary by the fact that companies could not maintain the stocks which they had a few years ago without such loans.—Mr. *Albu*: May I point out that most of those companies have been operating at a very much higher level of activity than they were prior to 1939.

3582. Higher activity in terms of money or in terms of volume?—In terms of volume.

3583. Is it not a fact that stocks at the end of the war were at their very lowest ebb for many years, because in many industries the bulk stocks were being carried by Government departments instead of by companies?—I am not very sure about that. I should imagine in some industries it probably was, but I should have thought it was very different in others. I can only now speak from personal experience. Companies which were engaged pretty actively during the war, and probably in fact expanded their activities during the war, were probably holding larger stocks, and probably holding larger stocks for another very practical reason: if one had to operate at all continuously one had to have much larger stocks. One could operate on very small stocks before the war, when supplies were available at almost a telephone call, but during the war one had, if one was to operate continuously, gradually to build up much larger stocks in order to carry on at all. Of course, it would have varied considerably between companies, I fully recognise.

3584. And probably between various sectors of the commercial set-up?—Yes.

3585. I wanted you to direct your mind to the question of the volume of stocks in 1938 and 1939 and the volume of stocks now, whether companies had been able to finance such stocks, replacing only to the 1938 volume, out of their own resources, or had had to go to the market.—I think I have already said in reply to the Chairman, one really cannot base a tax policy on what took place during the war. All sorts of injustices took place; all sorts of deflections of the economy took place which were quite unnatural, and whether or not one gives special provision for those, and whether or not one gives special relief for those, is of course another matter; but I do not think it is right to consider what should be the proper burden of taxation on industry, or the proper allowances, based on the history of a very peculiar period.

3586. You do not regard it as a hardship if a company is forced to borrow in order to maintain its position?—In normal times, no. If you are talking about the normal gradual rise of prices, or a normal expansion, I would suggest you will find . . .

3587. No, please do not bring in the word "expansion" at this stage, I want to keep it to maintenance.—If there is a general inflation, a continuing inflation in the economy, I do not consider it unjust that a company should have to borrow even to maintain its assets. I do not think that has had to be done since the war, let me make that quite clear. I pointed out some of the arguments in that letter I wrote to "The Times" on the 3rd December, but even if it were the case I do not think it is unjust that that should take place.

3588. Just one last point, on paragraph 45 of your memorandum, where you say:

"It seems to us in principle desirable that there should be distinctive rates of taxation on earned and unearned income, and that taxation on the rentier might be increased in certain circumstances without raising the earned income rate."

What circumstances are those?—Mr. *Jenkins*: Circumstances in which a Chancellor of the Exchequer was increasing taxation and thought it desirable to get more revenue from tax on unearned incomes.

3589. Would you say that the taxation on unearned incomes should be increased above those in the present Budget?—I think it is a very difficult question to give a direct yes or no to, in isolation. It has got to be considered in relation to other taxes which might be raised not have to be raised, but I would certainly not exclude it from my mind as being something which should not be done.

3590. Mr. *Millard Tucker*: Let me take up the last point. Would you make that differentiation apply to surtax as well?—Yes, I think there would certainly be advantages in doing that.

3591. Would you say that a total rate of 19s. 6d. is the £ was too high on earned income?—I would certainly have thought it was not ideally desirable. I would not have thought it was an ideal state of affairs.

3592. While you are on this subject, would you think it right to make everybody in the country pay some income tax, however small their incomes?—No, I would not have thought there was a particularly strong point there. The point, I imagine, is the "stake in the country" argument?

3593. It is bringing home to people the fact that everything they get has got to be paid for.—After all, there are great numbers of taxes besides income tax, and you do already have everyone making the social security payments which is of course a very regressive form of tax.

3594. But there are other things to be provided besides insurance and sickness benefit, and so on. There is the defence of the country, and the police, and all the other kinds of expenditure. I just wondered whether your view was that it would be a desirable thing?—Mr. *Albu*: I should have thought that that rests on assumptions which have never been investigated, as to whether or not the payment of taxes does give people the feeling they are paying for all these things. I think if one were to take a social survey of those who pay a few shillings tax every week and those who do not, you would not find that that was the main cause of the difference in the sense of responsibility, or a feeling that they were responsible for the country's expenditure, defence, and so on. I very much doubt that; there is really no evidence.

3595. In going about the country and speaking to various people, do you find that there is a tendency to look upon the Government as though it were something entirely outside the people themselves, and people say: "The Government ought to do this for us", and: "The Government ought to do that for us" as though it is some rich uncle on the offing who has got an unlimited pocket?—In my own experience, and of course I am a Member of Parliament, that is not the case. I cannot say that personally I find great demands coming from my constituents for all sorts of things which they ought to get. I think on the whole, over the last few years, there has been an increasing understanding of the economic problems which the country faces. I am sure there is a minority in all classes who are quite irresponsible, but I do not think it is true to say that there are a large number of people who do not realise that what is provided by the Government has to be paid for in some way. I think the increasing publication, for instance, of economic surveys and budget surveys in popular forms, and the whole of the economic education which has been going on, is having a considerable effect. We have still a long way to go, but I think that is by far the better way of getting people to understand their responsibilities, rather than the way of making everybody pay a few shillings income tax every week.

3596. So you would be against the proposal which lowered the starting point?—Yes, in principle.

3597. What is the justification in your view for, say, letting a single person start his taxable liability at £135 a year?—I am afraid I have never considered the exact figure at which one should start.—Mr. *Jenkins*: But the question was more related to the existence of a figure than to a particular figure?

3598. Yes.—I would have thought the justification was precisely the same as the justification for having a generally progressive system of direct taxation.—Mr. *Albu*: If I might say so, the single man, for instance, can hardly forget that he is paying tax every time he goes

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into a pub, which is far more likely to bring it into his mind than having a shilling or two taken off his wage packet each week.

3598. He may be a tectonist and he may be a non-geometer, and he may not go to the theatre or the cinema. Will you now turn to the subject of capital gains, on which I have one question? You have answered a lot of questions, and a lot of the ground has been covered, so I need not go over it again, but I was considering your suggestion about the carry-forward of capital losses. You suggest that they should be limited to three years, for example?—Yes.

3599. If you made a capital loss in the Year 1, Year 2 would be the last year in which you could set it off against a capital gain. I suppose you would include in capital losses such things as this: a man buys a motor car for his own use, keeps it a couple of years and then sells it at a figure less than he paid for it. Would you admit that as a capital loss?—Mr. Jenkins: Exactly what you include both for the purposes of gains and losses is a fairly detailed administrative point. I would myself be inclined not to include, in the case of individuals, household effects, furniture, and things like motor cars.

3601. Would you include antique furniture?—I agree you do get into great marginal difficulties.

3602. Pictures?—I would be inclined to exclude them.

3603. The whole matter bristles with difficulties, does it not? We cannot say it is impossible because it is done in America, but of course there it has got a distinction between short and long term gains. But all those things would have to come in, would they not, and add to the general further administrative work to be done?—You do have to make choices at certain points between being very fair and very accurate, and being hopelessly administratively cumbersome. I think that applies to any tax.

3604. I have only one question to put to you about this new question of replacement costs. I would like you to amplify one of your answers to the questions Mr. Carrington put to you. Would you agree that as a general proposition a business, never mind whether it is a company or an individual, a business to-day, which has to carry a stock of a volume equivalent to that in 1938, requires roughly about 2½ times the amount of money necessary for that purpose?—Mr. Albu: I think it would be quite impossible to give an overall figure. It must depend very much on the industry and the nature of the raw materials.

3605. I do not want to pin you down?—I would not disagree with the general point.

3606. But can you point out to me anything which one business is dealing with that has not gone up considerably in price, apart from food, which is controlled?—I believe quite a lot of chemicals, for instance, are cheaper than they were before the war.

3607. But generally, of course, it is true, is it not, that the price level of things has gone up?—Yes, I agree.

3608. But with stocks I think your view is that you would have had to do that whether you had any tax or not, you would have had to find extra money owing to the prices having gone up?—Whether you had to find extra money, I am not quite certain. My examination of the figures published by the F.B.I. leads me to believe that the actual rate of profit which has been made in the companies quoted in the samples was quite adequate even with the present taxation to cover the maintenance of the assets, both fixed and current assets, though I admit that this was only taken to 1949 and we did have this very extraordinary period of 1951, with extraordinary rises in commodity prices.

3609. Your general approach to the question of replacement of fixed assets is rather this, is it not: you do away with the strict legal conception of the company being a separate person from its shareholders, and you look at the business and the individual shareholders, do you not?—Yes, if I understand you right.

3610. Most of your arguments have been addressed to the position of the ordinary shareholder?—I think we have dealt with the economic arguments as they affect the company as well, but we are concerned to make it clear

that arguments directed towards the economic position of a company also affect the personal wealth and private income of the ordinary shareholder.

3611. You cannot help it?—It cannot be separated.

3612. But I meant that your approach is one which emphasises rather more the net result on the real owners of the business rather than on the business as a separate entity?—I would not say we emphasised it more, but we were at pains to point it out.

3613. I think you implied that other people have not given sufficient attention to that?—Most certainly, because if I might say so I think the arguments are generally put forward not on grounds of justice or equity for individuals but on grounds of economic necessity from the point of view of the national economy, and we are at pains to point out that you cannot separate these two.

3614. Yes, I am not questioning it, I am merely emphasising it a little. You object to the whole of the attention being directed to the business as a business, without giving proper attention to the results on the real owners of it?—Exactly.

3615. Mr. Millard Tucker: Thank you very much.

3616. Mr. Geoffrey Heyworth: I think you said in reply to a question by the Chairman that, if initial allowances were used as a weapon, you favoured differential allowances for various purposes. Could you just go a little deeper into that and give me examples of the sort of variations you have in mind?—Of course, we have actually included in the memorandum the variations, to some extent, according to size.

3617. I meant apart from size?—I can conceive of a situation in which it was really desirable to increase the investment in particular types of industries. Governments have in the past provided subsidies for particular types of industry, particularly for capital investment. Of course, the initial allowance was not so much another form of subsidy, it was generally called an interest-free loan to industries which it was desirable in the general national interest to expand.

3618. Had you in mind a variation of the use of initial allowances, for instance, to deal with structural unemployment?—Yes, most particularly, of course, where one wanted to provide a diversification; for instance, as at the present time in Lancashire, where it was necessary to try to get new industries established in a particular area.

3619. This is a geographical differentiation now. Everybody who went to Lancashire would get an initial allowance, whatever they did?—No, but I should have thought Lancashire was a very good example of structural unemployment. But I would not be against, for instance, such allowances being given to companies which did establish themselves in development areas, or in areas which it was desired to develop, although I should have thought that in such a case it would probably be more desirable or equally desirable to restrict it to particular industries which it was desired to expand.

3620. Then when you begin to follow that in detail, it is not so easy?—I am not denying it would be difficult to apply, but I do not think it is impossible.

3621. Just one small point on paragraph 31 (ii), where you say: "the short average life of the small company". What is the basis of that statement? What do you mean by it?—Simply that the risk is much greater for small companies; more small companies go out of existence. Companies tend to go out of existence in the early days of their life, rather than later on; obviously the risk is greater.

3622. But you have not got any statistical information to show how serious it is?—I have not got it here, but I am practically certain there is a good deal of statistical evidence.

3623. Finally, a question on the small company point. You would agree that probably one different which has worked against the setting up of a new business, whether it be a company or whatever it may be, arose through the re-distribution of income; in other words the traditional source of the bright young man, who had no assets, was that he either knew somebody, or had an uncle or someone who kept his eye on him, and he could get a bit of money to start?—That is quite true, but it is a rather surprising thing, the enormous growth in company formation in recent years in private companies;

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[Continued]

and although one would have thought that was true, I have no evidence but I suspect a lot of people are starting up in businesses of all sorts, and I am not really sure that the rate has fallen off.

3624 In those particular cases people were lending money, the first £200 or £300, or £2,000 or £3,000, on the basis of faith in an individual, they thought he was a pretty good chap and that was the basis of it; but when we talk about semi-public or public finance organisations it is extremely difficult for any such instrument to bring this kind of judgment to the estimation of whether a man should be financed. I do not see how you can possibly replace that by a machine of that type—I would first of all say I think we have got to find a way, that is something which certainly will have to be done. I see no reversal of the present trend. But it is also one of the reasons why we actually put forward proposals for assisting the new company to retain more of its profits for its own expansion from its own resources.

3625 I was rather dealing with the particular case of a man who had no money, that is the man we are concerned with; without the money he cannot get started.—Mr. Jenkins: I think it is possible to exaggerate the extent to which a financial institution is incapable of backing a man with an idea. I should have thought that the people responsible for taking these decisions would say that the thing by which they were very greatly influenced in the case of small businesses was the standard of management.

3626 Sir Geoffrey Heyworth: Often it is the character of an individual, and that is pretty difficult to measure through any organisation.

3627 Mr. Greenwood: In paragraph 25 you say: "It is clearly quite wrong to allege that the tax system is preventing industry from maintaining its physical capital intact, or even that high taxation is an effective limitation on expansion." I am going to put a case to you, and I should very much like to know if you maintain your view. This is a case which must happen very often with companies; this is an actual fact, not theory at all. A company had acquired a large area of land to put up an important factory, and its business was likely to be good for export, and so on. It was going to get every backing from the Government, so there was no question of any limiting factors as far as licences, and so on, were concerned. It paid £30,000 for this land. Estimates were got out and the whole project, with roads, and so on, was going to cost £3 million. The estimated profit from that was £300,000, 10 per cent. You could not call that unreasonable, I think, could you? When the board came to go into the figures (they would have to borrow money for that, of course: I am going to say 5 per cent. preference shares, because actually the ordinary shares were on a 5 per cent. basis, the yield on the market) they found that after borrowing this money, paying profits tax and income tax, the sum left in the business, after risking £3 million was between £13,000 and £14,000. Do you think that that height of taxation is likely to encourage expansion? Do you not think that is too high?—Mr. Albu: It is extraordinarily difficult to deal with individual cases.

3628 It applies to any company which is going to spend money.—First may I say, as regards the argument in these lines you quote, perhaps the end of the sentence is not so happily phrased, and we should have said that a higher level of taxation has not been an effective limitation to the expansion of industry as a whole. It could not have been, because if it had been we should not have had either the full employment or the expansion of production that we have had in these years. That is taking industry as a whole, and I think it is very difficult to see what further expansion could possibly have taken place in these years. If one takes an individual company, I am afraid that without an examination of the whole of the figures I really would not like to answer it. It sounds a very difficult case.—Mr. Jenkins: Of course, on the figures given I do not think one knows what the ordinary investment was.

3629 It does not matter what the investment was. If you were faced with spending £3 million and getting a return of £13,000 to £14,000, would you not think that that was hardly likely to encourage expansion?—But I understood that part of the £3 million was to be raised in preference share capital.

3630 I said that because it just happens to be 5 per cent., it could have been raised in ordinary shares which actually would have paid 5 per cent., that was the market valuation at the time. It does not make any difference whether it is ordinary or preference.—It does seem to me very important to know on what amount of capital the return of £13,000 is obtained.

3631 On £3 million—I am afraid I do not then understand how the preference shares come in.

3632 Call it ordinary shares, if you like, but do not call it debentures, because if it was debentures or borrowing from the bank the return would have been £70,000 or £80,000. You have borrowed £3 million in preference shares, if you like, or ordinary shares, which are going to pay 5 per cent., and the dividend required is £150,000; that is right, is it not, at 5 per cent.?—Yes.

3633 When you have taken off profits tax and income tax you are then left with the magnificent sum of between £13,000 and £14,000 for risking £3 million. I do not think that encourages expansion.—Mr. Albu: Is the £13,000 or £14,000 what is left for the ordinary shareholders?

3634 It is, if you like, cash left on the whole transaction, per year, of course, each year.—Mr. Jenkins: That is the amount net of tax left after the ordinary shareholders have received the dividend which, given the market standing of the company, they consider necessary to invest the money?

3635 Yes, 5 per cent.—So of course the actual return which they consider necessary to put the money in, given the market standing, is covered before you come to the £13,000?

3636 Yes, it is paid for by the dividend on the preference shares or the ordinary shares, but the company does not get it, the company has only got £13,000 or £14,000 left.—That is all it has got left to expend beyond its present size?

3637 It is risking £3 million for the chance of getting £13,000 back.—But surely the risk of £3 million is covered by the fact that the market thinks 5 per cent. is the appropriate return to the ordinary shareholders.

3638 We will say preference shares. All the company, as a body, is going to get is £13,000.—Mr. Albu: But surely the essential point here is, what is the risk as measured by the market, and apparently the risk as measured by the market was a yield of 5 per cent. on the ordinary shares, so it does not look as if the risk was considered very high. It is very difficult to deal with these individual cases. . . .

3639 You misunderstood me. I am saying there is no incentive for a company to expand.—I am not sure; who is the company?

3640 It is my own company, Boof's Fine Drug Company, if you want to know the exact company, because I believe in talking facts and not theories. I do not believe you people realise how much is left owing to this terrific taxation, how much you do get left out of a big project like that—I think we are quite well aware of it. It involves us in a whole lot of interesting discussions as to why you should continue to run Boof's Fine Drug Company at all.

3641 I might say that the project never came off because we had to risk £3 million and all the company was going to benefit was £13,000. It was not worth it and that was exactly what happened.—It is awfully difficult in dealing with individual cases.

3642 No, taxation is the same with every project.—It may be; but the fact is that we really could not have, in the last few years, expanded any further. If you had expanded that, something else would have had to have been foregone, and whether it was desirable or not that you should have done it I am not sure. It may have been that this was a hard case, but the fact is I cannot see how an investment of £3 million and the consequent production could have been taken up during the circumstances of the years up to the beginning of this year without some consequent expansion elsewhere not taking place.

3643 Suppose we take it a little further, when there is no limitation and you can get building licences very easily and plant very easily, do you not think that this high taxation will have quite a serious effect on initiative and

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expansion?—Mr. Jenkins: You are assuming, really, a state of affairs in which pressure on resources is very much less than it has been in recent years?

3644. Yes.—Which probably means a state of affairs in which you have fairly substantial unemployment, because I would have thought it was the case that if you get away from a position in which you did not have pressure on resources, then you would slip the other way. My first answer would be that in those circumstances there would be no doubt be a somewhat lower rate of tax than there is at the present time, and that our argument in favour of present rates of tax is related to recent experience, which has been that of the full use of resources. Of course, one would have to consider the problem afresh in different circumstances.

3645. When you were replying to Mr. Kaldor you referred to the adequacy of reserves. Would it not be true to say that some of the companies which have the best use of reserves to their capital issue are the very companies that have no cash?—Mr. Albu: It may very well be so.

3646. You said reserves, but really reserves is not quite the right word?—I am not quite sure what the actual question was. I think what I really meant was that in the period since the war the amount retained from profits, able to be retained, was adequate to cover the needs to maintain the assets, both fixed and current assets, and that if one examines the figures published by the F.B.I. it will be seen that in the period since the war this is so. The F.B.I. was of course doubting the adequacy of retained profits in the future. I made an estimation based on their figures that something like 0.3 per cent. of their 1949 sales turnover, which is probably something between 3 and 10 per cent. of their net profits after tax, would be adequate to maintain the assets, but of course not for expansion.

3647. Mr. Kerwick: Just two very small points, following a question of Mr. Crick's on capital gains. Am I right in my understanding that your society's, or group's, chief interest is in the social justice of capital gains?—Mr. Jenkins: Yes, I think that is so.

3648. And you would have that social justice regardless of the cost of collection and regardless of the yield?—No. Obviously that would be a most dogmatic position to take up, and certainly these might be administrative arguments presented to us which might show that the cost was entirely prohibitive, but we would say that there was a substantial gap in the system of taxation at the present time, in so far as while some people were paying very heavy rates of tax on all their income other people were paying no tax at all on capital gains which undoubtedly, in some cases, increase the total money they have available for expenditure. We think that should be looked at and set off against the administrative difficulties.

3649. In deciding your views on this, did you go into the question of the cost of collection?—No, we of course did not have the facilities to obtain evidence from the Inland Revenue, for instance. We looked at the American experience, which certainly was sufficient to suggest that it was not likely to be prohibitive.

3650. Would you say that the American experience was in any way comparable to that which we might expect here, since I understand that the Americans introduced it on a rising market? There may be a very grave danger, supposing we adopt any suggestions along those lines, of introducing it on a falling market, therefore the yields, that you make a comparison of, in America were not of really great substance when considering the problem in this country.—You mean, the starting point is of great importance, and remains of great importance?

3651. I am not being dogmatic either way. I just wondered what your view was on that problem.—Mr. Albu: I should have thought the starting point is an important feature of a capital gains tax, I agree.

3652. I wondered whether you had considered that sort of point when you made your recommendation, or whether it was entirely on social justice; one can quite understand that point of view, but I wondered whether you connected it with the more practical considerations which at some time would have to be considered. I gather not?—Mr. Jenkins: Certainly we would regard the starting point

as being of great importance. There would obviously be nothing to be said for taking the first six months of 1931 as one's base and operating from there over the next few years.

3653. I have a point on your small companies. Do you think, in making this suggestion, or adopting this suggestion, there would be any danger or tendency for the investors to adopt a structure of a series of small companies merely to get the advantages which you suggest should be offered to small companies?—Were you thinking of companies belonging to one group?

3654. I was not necessarily thinking of companies belonging to one group, but if you introduce one form of taxation you obviously immediately have to see how it is going to be evaded, and there must be a technique for getting advantages through a structure of small companies.—Certainly, in so far as one was dealing with a group, obviously the restrictions which were applied to the excess profits levy, for instance, could *mutatis mutandis* be applied here. So far as it was not a question of a group, I should not have thought that concessions on the scale suggested were likely to result in the splitting up of any large industrial combine in order to take advantage of them.

3655. You may be right, but when taxation is on a very high level the wit of the investor is very ingenious in finding ways of dealing with any concessions that you are giving to any selected group which you assess merely on size.—It is of course the case that one does already in the case of the profits tax legislate for an abatement on profits tax for small companies, really very much along the lines of our suggestion here, allowing for differences between initial allowances and the profits tax, but I should have thought there was no evidence that company structures were deliberately re-arranged to take advantage of that concession.

3656. I just wanted to see whether your suggestions, in practice would work.—Mr. Albu: I have thought of this quite a little, and I cannot think of any way in which it could be done on any extensive scale, so that it was not possible for the Inland Revenue to deal with it. I think it would be far more bother to the companies than would be worth while.

3657. Professor Hicks: On this last question of Mr. Kerwick's, you have shown that there are some economic reasons for discriminating in favour of the small company. Looking at it from the point of view of equity, do you feel there is any tendency for shareholders of small companies to be less wealthy than shareholders of large companies?—I have rather strong personal views on this. I think there is, yes, but size is not perhaps the only feature. I think one has to face the fact that with the majority of public companies, the whole of the control, the policy and everything else is really in the hands of the directors, with very little influence from the shareholders, and that the shareholders are not affected by the dividends they receive except in so far as they will or will not put up the money, and that is a matter, of course, of the risk and the yield. But in the case of the smaller company, which is owner-managed, the profits are a very direct incentive. If you have a small group who are making their own money and working in a business, of course the situation is very different indeed, and I personally would be pleased to see considerable concessions given to such a company so that the owners can build up the business to what is an optimum size.

3658. That is to say, some of these shareholders of small companies may be more worthy members of the community than the shareholders of large companies; it does not have any bearing on their actual income?—It is a sort of economic justice, but I did not say they were more worthy members of the community. It is perhaps really almost more expediency than justice. If you believe in the incentive of profit, then it is advisable that the profit should go to those who can most influence the efficiency and enterprise of the company, rather than those who can play no part in it.

3659. But that does mean that you are going on quite different principles than you are in the rest of the tax.—Mr. Jenkins: I do not think we intend for a moment to put forward our special concessions to small companies on the ground that they would in themselves be redistributive, but merely within the broad field of redistribution

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taxation there was need to deal with specially hard cases, and we thought small companies were such cases.

3650. I appreciate very much the very clear distinction which you make between the economic effects of taxation on undistributed profits and distributed profits. You hold that to soften the taxation on undistributed profits, although it might have something to be said for it from the point of view of economic effects, at least in some circumstances, perhaps in the recent past, would have distributive effects which you would deplore, and the only way you suggest of cutting that out is by initial allowances. I was wondering whether you had considered what would seem to me to be an even more direct way of dealing with the matter, which would be to allow firms to make payments of taxes which fall on undistributed profits, to some extent, in the form of bonds on the company itself, that is to say, giving it the right to borrow its taxes back from the Government, up to a certain proportion?—MR. ALBU: I think that would be a quite interesting suggestion.

3651. You would be, on the whole, quite attracted by that?—Yes.

3652. A considerable part of the initial allowances plan and of that plan of course would overlap.—MR. JENKINS: It would have two effects which I should have thought would need looking at; the first is that it would presumably increase the pull over investment resources from companies with large profits as opposed to other companies who were setting themselves up afresh, and in the second place the question of the rate of interest which was to be paid to the Government would be of importance. If that were lower than the rate at which a company might raise capital in the open market, the proposal of course would still have the effect of benefiting the shareholders of the company.

3653. The scheme would be rather flexible from that point of view.—MR. ALBU: My mind is not closed to any suggestion of this type, if for instance the situation which Mr. Greenwood described was a widespread one in any industry.

3654. If a scheme of this kind were to be adopted it would mean that over a period of years companies would be involved in additional fixed interest charges due to the Government. Since the initial allowances plan so largely overlaps with the plan I have just been suggesting, the question does come up whether we ought really to regard initial allowances themselves as involving a company in additional fixed charges which would have some of the same weight. That being so, again, looking at the matter with regard to the future (with which I think this Commission has to deal, rather than the particular position over the last few years), it seems to me that we have to consider the danger of involving companies in excessive fixed interest charges or fixed charges of this sort,

The witnesses withdrew.

SIR HENRY CLAY: called and examined.

MEMORANDUM SUBMITTED BY SIR HENRY CLAY

1. I wish to offer evidence on one aspect only of the Income Tax—the influence which it exercises on the capacity for growth and adaptability of industry.

2. Income Tax at present is levied on income irrespective of the use to which the income is put, i.e., in the case of trading profits irrespective of their distribution between dividends (or proprietors' drawings) and reserves, from which expansion and expenses of adaptation can be met. While the tax thus does not discriminate in favour of additions to capital formations out of profits, the rules for defining net incomes have the effect of discriminating against maintenance of capital. In the main the cost of replacing wasted assets, whether fixed assets which wear out over a long period of time, or material which is used up currently and has to be replaced currently, is calculated by reference to historic cost, i.e., the actual expenditure on the equipment or the materials used. If the level of prices has risen since this historic cost was incurred, the provision allowed will not suffice to cover the cost of replacement, so that the effect of Income Tax is to reduce real capital resources and, to that extent,

although it may be some time before the danger becomes very pressing. Do you think that is a danger we have to be careful about?—MR. JENKINS: I would certainly have thought the position in which a company's capital structure became excessively highly-gear'd was undesirable.

3655. I would like just to link up what has been said with what you say about profits tax. You suggest that it would be a good thing to allow preference dividends as a charge for purposes of profits tax, in the way that fixed interest payments are now allowed, the reason being that the present system of profits taxation discriminates against borrowing on preference, and consequently in favour of borrowing on debentures or fixed interest. It seems to me, however, that by your proposal you are just shifting the point of discrimination, that instead of discriminating in favour of debentures against preference and equity, you are going to discriminate in favour of debentures and preference and against equities. I cannot see what the point of that discrimination is.—The point we attempted to make in our paper was that we were disturbed about the levying of profits tax upon preference shares, not because it was inequitable but because it might have an undesirable effect on the capital structure of companies. By saying it was not inequitable, we meant it is already the case that it is the ordinary shareholder who in fact bears the profits tax which is nominally related to preference dividends. A preference shareholder gets the dividend in exactly the same way and his income is in no way affected by the profits tax. What we propose is that what is in fact already a burden on the ordinary shareholder should be made nominally a burden on the ordinary shareholder, because the effect of that would be to put the preference capital and loan capital in the same position, and we thought that would have the desirable effect of making companies more ready to raise preference capital, which has certain advantages. But I see no way of avoiding the fact that if you do have a profits tax it is the equity shareholder who in fact has to pay.

3656. Have you considered the other alternative of not allowing debenture interest, putting them all on the same level?—That would certainly be a possible way of approaching it, which would deal with the particular points we are concerned with almost equally well.

3657. It would have the advantage that the profits tax would effectively weigh upon all forms of raising capital, and consequently be more effective in controlling investments?—There may well be an answer to this which I have not thought of, but there may be a difficulty about the position in which a company paid its debenture interest by depleting capital because it had not made any profits.

Chairman: We are much obliged to you, Mr. Albu and Mr. Jenkins, for a helpful morning.

the capacity of industry. I wish, first, to refer to the importance which self-financing out of profits has for the growth and adaptability of industry in general, and particularly in the special circumstances of industry after the dislocating effects of war.

3. Profits are the chief source of finance for private industry and trade. "Small savings", in the form of purchases of Savings Certificates, additions to Savings Bank deposits, Savings Bonds, and deposits and share capital of building societies, are used to finance Government needs or house purchase. The new issue market is handicapped in providing capital for most firms by the difficulty of assessing management or prospects of any except large well-established concerns; and the minimum costs incident to a public issue make it an expensive form of raising capital in sums of less than £500,000. In the past the market has been mainly concerned with raising money for Governments at home and abroad, for large utilities, including railways at home and abroad, mining enterprises in countries with little capital of their own to draw on, and a minority of large established indus-

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[Continued]

rial concerns. In the last twenty years it has been concerned much more with British industry and trade; but its function has been mainly to finance the transfer of concern, which have already accumulated their capital assets out of profits, from the hands of the families which built them up to the general public, not to provide, or only incidentally to provide, new money. Existing concerns have in the main grown out of profits, and this is still the chief source of growth. The table (34) in the National Income White Paper (Cmd. 8303), giving the appropriation of corporate income shows that in 1950, out of total income of £2,264 millions, undistributed profits amounted to £569 millions; in 1938 the corresponding figures were £338 millions and £172 millions. These figures of undistributed profits (for corporate enterprise only) may be compared with the estimates of gross personal saving, £332 millions in 1950 and £222 millions in 1938.

4. Not only are undistributed profits the chief source of industrial capital; they are probably the most productive source. The practical problem involved in directing new capital to industrial development is to assess first the prospects of the enterprise, which involves a judgment of technical and market conditions difficult for anyone outside an industry to make, and second the management, which is even more difficult for an outsider to judge. The application of profits earned in the concern and not distributed ensures automatically that at any rate the new capital is applied at a point at which profits are being made. There is *prima facie* evidence either that the concern has found an outlet for its product in a want for which the market will pay, or that it enjoys a degree of managerial efficiency sufficient to maintain and probably expand it. I am aware of the deficiencies of profits as an index of social need and a test of managerial efficiency; but it is the purpose and achievement of modern social legislation to supplement the deficiencies of markets on the side of social need, while, defective as profits are as an index of managerial efficiency, an index which reflects market and managerial conditions is much better than no index. Issuing houses admit the difficulty of judging entrepreneurial efficiency by the comparative rarity of their issues for entirely new firms; and, although the provision of starting capital for a new firm is a different problem from the provision of additional capital for an existing firm, the difference in practice is not very great until a firm has existed long enough to demonstrate that its management and/or its place in the economy justifies the use of additional capital. The Capital Issues Committee regulates the flow of new capital to some extent; but it does so only by reference to very broad priorities; it does not attempt to judge managerial capacity, or the market prospects of the project for which capital is wanted, but on the contrary is careful to disclaim any responsibility for the merits of the issues it approves. This attitude is inevitable in a judgment by an outside agency of the mixed technical, commercial and managerial problems raised by a new issue. However firms secure their starting capital, therefore, they present a *prima facie* case for the application of such savings as they can make out of their own profits merely by making those profits.

5. The rise in income and estate duty taxation since the outbreak of the First World War has increased the importance of profits retained in the business as a source of new business capital. Before 1914 in most industrial areas successful business men retained a large enough share of their incomes to be able to offer backing to younger business men on the basis of a personal judgment both of the applicant's business and his character. Today their resources are depleted by high income and Surtax, and they are forced to invest most of what they do save in market securities which can be realised to meet death duties.

6. The availability of as large a share of profits as business can be induced to keep in the business is of importance in enabling industry to meet trade fluctuations. The general causes of such fluctuations are beyond control by any single business; but there is in trade depression usually an element of structural change which increases the difficulties of some trades and lessens those

of others. Some industries and firms are declining, others growing; the depression will be shortened if the firms which are tending to grow can be assisted; just as it is possible, though not a reason for refusing assistance, that recovery will be delayed if firms in declining industries are assisted to fight against the trend. The development of the firms and industries which have the capacity of expansion is a matter in a depression of finding new products, new processes and new markets. If these can be found the firm or the trade will be able to stimulate a revived demand for its output earlier than it would if it depended wholly on the general conditions affecting business activity—such innovations enable it, as it were, to turn the flank of depression; but all such innovations involve capital expenditure—on experiments, on equipment, on marketing. In a depression the difficulties of all firms in raising new capital from outside are intensified, and for small firms are often insuperable; their own profits are the only source on which they can expect to draw. At present, if they have found such outlets, they are handicapped in taking advantage of them by Income and Profits Tax amounting to more than half their profits (and in addition, by Surtax on partners' income in case of private firms, which are particularly important in this connexion). Even if the entrepreneur regularly turns back into his business the greater part of his profits, present taxation seriously handicaps him.

7. Even if the contingency of trade depression be ignored, an ample provision of new capital at the points at which market demand or technical advance is pressing on industry is essential to rapid growth. Most of the comparisons between productivity per man-hour of American and British industry show not only a higher productivity in American industry but a much greater employment of capital per worker occupied. Again the absence of depression for any considerable time in industry since the war has been accompanied by a continuous and almost universal shortage of labour; a more intensive use of labour by the provision of more extensive capital equipment is one way of meeting this shortage.

8. The need of adaptability, and consequently of setting free capital for the expenditure involved in financial adaptation, is greatly accentuated in the period following a great war. A war checks the piecemeal adjustment to change in technical and market conditions which serves in a peaceful world to keep industry broadly directed to purposes in which market prices will cover costs. It goes further, and diverts resources from normal peace-time needs to necessarily temporary wartime needs, calling for re-adaptation when the war is over. As the First World War illustrated, war may also confront industry after the war with a new environment calling for an extensive reorientation of resources; nationalist feeling may express itself in protective policies and exclude an exporting industry from a traditional market, as Indian protective policy excluded the English cotton industry between the wars from what had been its greatest market, and every country set about building up its own supply of manufactures which it had imported before the war. The following tables may serve to illustrate, first, the continual shift in the direction of industry over long periods; and, secondly, in more detail, the large shifts that took place between the wars, even after the first adjustment to post-war conditions had been effected.

PROPORTION PER 10,000 OF OCCUPIED POPULATION IN GREAT BRITAIN IN DECENNIAL CENSUS IN CERTAIN INDUSTRIES, AND RATE OF CHANGE

	1911	1921	Percentage Change	1931	Percentage Change
Agriculture ..	779	675	- 9	567	- 9
Coal-mining ..	615	474	+ 16	553	- 11
Metals, machines, conveyances ..	289	1,287	+ 40	1,344	- 3
Cotton textiles ..	352	321	- 4	280	- 5
Woolen textiles ..	142	134	- 1	118	- 4
Total Occupied Population			+ 5		+ 9

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[Continued]

TRENDS OF EMPLOYMENT 1923-1936

(numbers employed, i.e., number insured less numbers unemployed, in certain industries as per cent. of number in 1923)

	1923	1929	1931	1936
All industries ...	100.0	110.5	101.7	117.6
Coal-mining ...	100.0	74.0	56.8	52.9
Cement ...	100.0	176.4	174.6	233.6
Rubber, etc. ...	100.0	140.7	128.4	176.4
Chemicals ...	100.0	111.5	96.0	107.5
Steel ...	100.0	89.6	54.5	89.4
General Engineering ...	100.0	105.8	81.6	101.8
Electrical Engineering ...	100.0	144.4	141.8	174.7
Motors, cycles, aircraft ...	100.0	134.4	115.5	172.1
Cotton ...	100.0	109.0	74.4	80.0
Tailoring ...	100.0	109.9	109.5	109.3
Printing ...	100.0	119.7	120.1	124.1
Baking ...	100.0	126.8	117.9	152.8
Distributive trade ...	100.0	136.9	144.3	160.5

9. Some similar reorientation is likely to be required as a result of the Second World War; though the long process of re-stocking and re-equipping which has followed that War, succeeded in turn by a new wave of rearmament, has so far produced inflationary markets throughout the world and relieved the older exporting countries like our own of the necessity of finding new outlets. The plight of the so-called "depressed", "special" and "Development" Areas between the wars was a symptom of the new environment in which the industries which had grown up largely on export found themselves after the First World War.

10. This discussion of the importance of the element of new capital, represented by profits retained in the business, may serve to make a *prima facie* case for special treatment of such profits in any system of taxation of income. The case does not of course override the claims of equity and capacity in devising a tax system. It is rather a case for treating as a limit on capacity to pay tax the need, if business is to have any adaptability and the capacity of growth, to retain a large proportion of profits before taxation, provided they are not distributed. The need would be met by differentiating between profits distributed and profits retained, charging a higher rate of tax on the former and a lower rate on the latter. I am not competent to judge how serious would be the administrative difficulties in differentiating retained profits from others. One alleged difficulty, the need of defining and enforcing conditions on the use of the retained profits, does not seem to me a difficulty; so long as the profits are not distributed and made available for personal expenditure, but remain available solely for the purposes of business, they are certain to be used for growth and adaptation, and the method and time of using them are best left to the directors of the business. It is necessary only to exact the higher rate of taxation, should retained profits subsequently be distributed in cash and so made available for personal expenditure. This may involve a higher standard of accounts than most firms at present attain. But the privilege of a lower rate would be conceded only on application and case made; and account-keeping would be improved. A distribution in the form of bonus shares, not of cash, does not take the capital out of business and therefore need not be penalised. The definition currently of the two categories, distributed and retained profits, should not be difficult where proper accounts are kept, since dividends and, in the case of private firms, proprietors' drawings, can be identified. The differentiation is already made in Profits Tax. This is (I hope) a temporary tax; when it disappears I suggest this differentiation may be incorporated in the part of Income Tax dealing with business profits.

11. Objection will be urged to such a treatment of profits on a number of grounds. There would be objection to differentiation as such; the definition of profits is a matter of sufficient complication without further differentiation when they have been defined. It can be urged against this that experience has forced already a considerable amount of differentiation. Profits Tax, as has just been pointed out, already includes the differentiation proposed. There is, in addition, a good deal of differentiation already in the treatment of personal incomes. Thus, while the

profits of private businesses, and of some companies which are effectively controlled by a small number of stockholders, are wholly attributable to the proprietors or income and, as such, are liable to Surtax, in practice, the Inspectors and Special Commissioners have, and regularly exercise, the power to exempt a proportion of such income as they think proper from Surtax so long as it is retained in the business. Again, the principle of differentiation in forms of saving is already recognised: contributions to statutory pension funds—a form of provision for the future—enjoy some exemption from tax; complete exemption is enjoyed where the provision for the future is most complete, i.e., in the case of pensions of public servants, since these pensions, though really part of the remuneration of the public servant, do not appear in any form in his annual salary and therefore escape taxation.

12. Differentiation between profits distributed and retained, unless the relief given to retained profits was wholly offset by additional taxation of distributed profits, would involve a shift of taxation from the investor (including the business man whose capital is invested in his own business) to the rest of the community. There would be no discrimination, if the total tax collected from trading profits was divided between a higher tax on distributed and a lower on undistributed profits. At least an experiment might be made of differentiations within this limit. If it proved insufficient to have the effect sought, it would still be worth while studying the possibility of some relief on undistributed profits. The investor would not enjoy any advantage over others in income available currently for personal expenditure, since this would all be liable to the highest rate of tax or even to a special rate; but his wealth would increase with the growth of his capital. It can be urged against this that it is the function of the general provisions of the tax to provide protection against hardship, by way of exemptions and allowances, and that there would be no differentiation between investors and others in the treatment of their spendable income; but the case for special treatment of retained profits rests on the advantage to the community as a whole (including other taxpayers) of giving industry and trade the greatest possible power of adaptation and of providing capital for growth at points at which managerial and market conditions point to the possibility of growth. Without capital technological advance is likely to be barren.

13. I suggest, then, that there would be social advantages in the present situation of the country in modifying the existing Income Tax to give a positive incentive to the accumulation of additional capital out of trading profits. I turn to the complementary problem of the negative effect which the present method of defining taxable profits has in deflecting business capital. It will be convenient to refer to the discussion in the third chapter of the Report of the Committee on the Taxation of Trading Profits (Cmd. 8189) which states the problem and reviews the arguments for and against change.

14. The problem is "simply illustrated" as follows:—

"A machine which cost £1,000 before the war may cost £2,000 or more to replace today apart from any element of improvement. The depreciation allowance given for tax purposes in respect of the original machine cannot exceed the original cost less the scrap value, and the £1,000 or more excess cost of the new machine has to be found by the owner of the business either out of taxed profits or out of new capital. Again, the owner of a business who buys 100 units of stock at £10 a unit and sells them for £14 a unit has *prima facie* made a gross profit of £400; if, however, it costs him £15 a unit to replace his stock, he will have to find an extra £300 to finance the same amount of stock, and this he must do either by appropriating part of the £400 profit for the purpose or by raising new money."

15. The Committee rejects the view that (para. 90) "industry ought not to be called upon to pay tax upon profits which it has to devote to the maintenance of its productive capacity (measured in real terms and not in terms of money); or in other words that profits used to replace plant, etc., at present prices, or to finance a constant volume of stock, ought not to bear tax." The Committee's objections fall under three heads:—

(1) It would be reluctant to substitute as a basis for taxation "a theory which involves departing from known

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it of an existing handicap. On the contrary the purpose, which by implication the Committee approves, of expanding enterprise, will be served by relieving existing enterprise of its present necessity to use resources it could otherwise use for expansion, merely to avoid a contraction.

22. Though the problem arises from the change in the purchasing power of the money in which accounts are kept, it cannot be solved simply by revaluing capital assets at current prices, and basing future renewal and replacement allowances on the new values so established. If the price level continues to rise, the new asset values will sink back into history as the values they replaced had done, and future allowances based on them, though less inadequate than present allowances, may still be inadequate for the cost of physical replacement. Nor can an adjustment each year, of depreciation allowances based on historical cost by reference to an index number measuring the change in the purchasing power of money, meet the need; such adjustment would always fall short of making good the inadequacy of allowances in years when the price level was lower, and, if prices continue to rise, will not even cover the ultimate cost of providing for contemporary wastage and depreciation. The root of the difficulty is the use of any cost as basis for a replacement fund (whether depreciation or replacement of materials), which will be used at a future date, when prices will be at a level which cannot at present be foreseen. It is natural to cling to historical cost and to formal balancing of depreciation against initial investment in terms of money, since there is no other basis in existing accounts for an estimate of the expenditure that will be required when the replacement is effected; but under conditions of unstable money the balancing is purely formal, and may be completely irrelevant to the actual problem of finance with which the enterprise finds itself faced. The difficulty is similar to the difficulty with which the authors of pension schemes find themselves faced.

23. The Committee on the Taxation of Trading Profits rejected all proposals for dealing with the problem of inadequate depreciation allowances by any "valuation" based on price index numbers. It also rejected the proposal that an allowance dependent on the actual replacement of plant should be given. This latter principle, in my view, is the right principle on which to go, if there are no insuperable administrative difficulties; a business should be allowed to charge the actual expenditure in any year on replacement of plant and stocks as a cost against the receipts of the year. Such an arrangement would have clear advantages. The expenditure would be a known figure, not an estimate based on hazy calculations. The expenditure would be in money of the same purchasing power as the money receipts of the business out of which it would be met—there would be no lag of one behind the other. Replacement would become the sole responsibility of the directors of business who would choose its time and extent and build up or draw on reserves, as they saw fit; this placing of responsibility on them is desirable in a time when the value of money is changing, so that original cost is an unreliable indication of the probable cost of replacement, yet provision has to be made. Exemption from tax would encourage adequate replacement, while leaving industry to defer replacement when it had difficulty in meeting current demand for its products and accelerate it when current demand fell off. The essential condition to which any arrangement must be related is that money has lost the stability it possessed when the practice of basing depreciation on historic cost developed, so that provision for the need of replacement in, say, twenty years cannot be a matter of precise calculation.

24. The practical difficulty to be overcome, as the Committee points out, is the difficulty of defining "replacement". There is, however, some experience already with

a bearing on this practical problem. It must arise in defining repairs and renewals to be allowed as a charge against revenue. Replacement was the principle on which allowances for dealing with depreciation were based in the railway industry, both in this country and in America, for the greater part of its history. One objection, that the accounts and other records kept by many firms are not accurate enough to afford a basis for defining replacement, is an objection that has been urged against many reforms—the levying of an Income Tax at all, the prescription of company accounts as a protection for shareholders against dishonest or careless directors, the extension of Schedule D to farming; the practical answer has been that accounts improve under pressure, and, especially when some remission of taxation is to be secured, the need of justifying a claim for remission will give the necessary incentive to keep adequate accounts.

25. The practical difficulties of administration cannot be neglected, but they are not necessarily decisive; the grievance which the new principle is designed to relieve may be so serious that even a considerable increase in administrative complication and expense is better than neglecting it. The basing of depreciation allowances on historic cost was adopted when prices were more stable and the rate of Income Tax much lower: the rise in prices since 1932 has already made allowances on this basis inadequate to the needs of replacement called for to maintain the efficiency of industry; retaining that basis in the face of a further similar rise in the price level would amount to shirking one of the most serious problems of industry.

26. The acceleration of the rate of change in the price level has given additional importance to an allied difficulty—the capital depletion involved in treating as net income, for tax purposes, the increased money value of an unchanged volume of stocks and work in progress. In principle the allowance for this should take the form of a recognition of the fact that, although trading receipts and inventory valuations are swollen when material bought at a lower level of prices is sold (in more or less manufactured form) at a higher level of prices, this material has to be replaced immediately at the higher level of prices, if the physical volume of output is to be maintained, and this replacement absorbs the whole of the increase in trading profit due solely to the rise in prices. The L.I.F.O. method of treating stock is one way of giving this recognition.

27. The allowances suggested would meet the needs of the industrialist and trader for relief from the burden of the present method of determining profits for purposes of tax. It is not an objection that they involve differentiation between trading profits and other forms of income. Differentiation is proper if profits are sufficiently different from other forms of income, and in fact profits are the chief form of income in which drafts on capital, in the form of nominal income arising only because the present system of allowances does not provide for full replacement in times of rising prices, are treated and taxed as income. Other drafts on capital, such as inadequate allowance for the cost of repairs of houses, or the taxation as income of the element of capital consumption in annuities and in the income derived from leases, are entitled to the same consideration. But the great mass of incomes, which are earned by work and, since they do not involve the use of any capital of the worker's own, are not subject to the expense of replacing wastage, fall outside the problem under consideration. Everyone, however, is concerned indirectly with the effects of allowing capital equipment and stocks to run down, since other industry will be less productive, or, if the deficiency is made up out of new current savings, the rate of increase in society's wealth will be slowed down.

10.11.1951.

EXAMINATION OF WITNESS

3658. Chairman: We are much obliged to you for your very interesting paper, which we have all studied. I think it is right, is it not, that what I may call the opening theme of your paper is that there is no better source of capital to keep a business running or expanding than its own retained profits?—Yes.

3659. To be able to draw upon such a source has obvious advantages compared with any other method of obtaining the capital that is needed?—Yes.

3670. The thing we are trying to get to grips with, on which I want your help if you can help us, is this: along industry for the moment as a generalisation, would you say that, for whatever reasons, it is short of necessary funds?—I think so.

3671. Can one usefully generalise as widely as that, or should one at once begin to study the large or the small concerns, or various branches of industrial activity?—One, should, I think, examine industry as a whole, in

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industries, industry by industry, because the prospects and fortunes of different industries vary just as their problems vary; but I was looking at industry as a whole and it seems to me that, large as the profits appear, when deductions have been made for taxation, the profits placed to reserves are not large, and if profits were calculated to allow for full replacement of used physical assets, I think they would be inadequate for any considerable growth and re-investment such as I think is necessary.

3672. Where would one turn in order to get the statistical material to support that?—I think the material that suggested this conclusion to me was the report to the new issue market of concerns which have made large profits and distributed only a small proportion of them, and yet have found themselves unable to finance their business without bringing in additional capital. The only general source I can think of is the successive estimates of the national income and its distribution, published in the White Paper. The single figure that impresses me most there, if I may refer to the 1950 White Paper, is the figure of expenditure on fixed capital assets, which was just under £1,600 millions, that has to cover both replacement and expansion. Of that £1,600 millions, about one-quarter is new physical capital in the form of new houses, public buildings and that sort of expenditure, leaving only three-quarters for industry. The current depreciation allowances which industry was able to make in that year were between £400 and £500 millions, and since they were based on historic costs, I think they would be less than the actual replacement cost of the physical assets that needed to be replaced in the year. It therefore seems to me that if you valued the depreciation upwards it would come somewhere near, if not exceed, the total amount of fixed capital creation by industry, leaving nothing for new industry. I do not think there was no new development, but I think a good deal of new development must be offset in the economy as a whole by inadequate replacement of deterioration, and that, too, outside the industrial field, in the field of public expenditure. The £300 millions expended on new housing, even if you take into account the allowance for repairs, probably has some offset in the deterioration of a large number of houses which are not adequately maintained, which of course the existing rents do not permit.

3673. You spoke a minute ago of concerns that had to come to the capital market to finance their existing business. You had particular cases in mind, I suppose?—Unilever, Imperial Tobacco and Imperial Chemicals have all come to the capital market in the last three years.

3674. And those of course are very large industrial concerns to whom the capital market is open?—Yes.

3675. What could one say of the smaller concerns that have not the same facilities?—I do not know; I think they do in fact get a good deal of assistance from banks. They have made large profits, which have left them a substantial margin after payment of tax, but on the whole I doubt whether they have been able to do much in the way of new equipment, expansion, while retaining sufficient reserves to cushion them against a fall in material prices.

3676. I suppose it is difficult to get enough factual material to give one an overall picture with regard to that?—I think the Central Statistical Office might elaborate some of the tables which they give in the National Income White Paper, otherwise a sample enquiry would be necessary and it would have to be a very big sample if you were to cover the small firms.

3677. It has been said that there has been a limiting factor on capital investment since 1945 that has not been due to financial shortage but to physical shortage. Have you any view on that general statement?—There is a great deal of truth in that.

3678. I wanted to ask you a question on your proposals with regard to a differential rate for retained profits as against distributed profits. That is a proposal which you put forward to provide a scheme for stimulating the possession by industrial concerns of adequate financial resources for the future. That of course is carried out by the form of profits tax today, is it not? What is wrong with the profits tax, from your point of view, seeing that it does recognise to a very substantial extent just that distinction?—I think that is its one merit, apart from the revenue it raises. I think the chief objection is that it

discriminates against a particular form of income, income from commercial enterprises carried out by corporate bodies, which is rather a curious way of selecting income for differential taxation. And I believe, but here I am not expert, that the extreme spread between the tax on distributed profits and the tax on reserved profits is so great that if it is carried forward indefinitely it creates a liability on companies which must obstruct their development. Some companies now reserve 50 per cent. of their profits, because they feel that it is a liability they may have to face, and because they will sometime need to distribute those profits.

3679. It has been said that by allowing debenture interest and interest on notes to be charged against profits for this purpose, but not allowing preference dividends, has tended to distort the shape of company finance. Have you any views on that?—I think it puts a premium on increasing finance by loan, by borrowing rather than putting up risk capital, and on the whole that tends to make industry less flexible and more liable to suffer in the case of a sudden change from good to bad trade.

3680. It struck me, when you were advocating a higher rate for distributed commercial profits than undistributed, whether you would be able to maintain the present system of a standard rate of income tax charged on company profits which is passed on when they are distributed to the individual investor?—No, that has been put to me and I think it is an objection to the form in which I made my proposal.

3681. To take an example, supposing you had 5s. for retained profits and 15s. for distributed profits, you would be cutting yourself loose then, would you not, from the existing system of a standard rate?—Yes, you might charge the standard rate on distributed profits, and then allow the rebate on retained profits, just as you charge the standard rate on income and allow a rebate on earned income.

3682. If you charged a rate on distributed profits that was higher than the standard rate?—That I now think is bad; I think the standard rate is such a great convenience that other things should be adjusted to it.

3683. I was only going to ask you, since all these questions are open for our consideration, would you favour setting business or company profits loose from the standard rate of income tax which is applicable to the individual, and turning towards a corporation tax on company profits, or extending it to business profits by analogy?—Profits are not confined to corporate profits, and if there is any concession by way of rebate I think it should extend to private firms as well as to a corporate enterprise. To that extent I would like to see a concession to trading profits. I dislike the system of separate taxation of corporations, just because it does break up the income tax system and results in a system of taxation under which it is very hard to say what will be the tax on any individual income, as I think the case is in America.

3684. If you look at our existing system, under which we have profits tax, which is in effect a corporation tax, I think, and the excess profits levy, which is to some extent the same thing, we have not escaped that separation to-day, have we?—No. I think most of the defects, apart from what seem to be inadequate allowances for replacement of depreciation, the defects of our income tax all spring from the height of the tax. And I think the differential taxation of corporate profits is one incident of that. I should like to get rid of that; possibly it is impossible to get rid of it so long as it is necessary to raise so large a revenue under the head of income tax alone, but apart from that I think income tax is much the best tax we have, and should be the central tax in any budget.

The proceedings were adjourned for lunch.

On resumption

3685. Chairman: I want to ask you a question about the subject of your paragraph 19. You are dealing there with the question whether, in allowing against your profits any depreciation cost, that charge should be concerned in terms of historic cost or replacement cost?—Yes.

3686. One of the difficulties that strikes me there is that, by adopting replacement cost, you are borrowing an idea from the economists, are you not?—Yes.

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3687. You are really looking at what we may call the real value and not the monetary value?—Yes.

3688. Do you think you could borrow that principle from the accountants when dealing with depreciation and not apply it more widely to other aspects of your accounts?—I think so. It seems to me to turn on the definition of true income. If the income is produced only by the using up of material assets, machinery and stocks, then I think the exhaustion of those real assets should be treated as a charge before you ascertain true income. I know all sorts of technical difficulties, in calculating costs and so on, arise but if those can be overcome, only by allowing this as a charge do you ascertain true profits and once that is done they would share the same fate in an inflationary period as any other form of money income. The person whose income is derived from work does not use, except to a slight extent, fixed assets and material stock. He works with his hand or brain and therefore there is no need to make him an allowance for exhaustion of assets which he does not use. It seems to me it is a different kind of income.

3689. I quite appreciate your view, that the business income is in a class by itself, but I was not really thinking of the personal position of the receiver of the money income; I was thinking of the business accounts. You bring in as a charge, against the money receipts of the year, the revenue receipts, the replacement expenditure?—Yes.

3690. But should you not, even in those accounts, remember that some of the outgoings like the service on your borrowed money show you a profit by virtue of depreciation?—Yes, those charges do not go up.

3691. To put it in the language that is sometimes used, you borrowed in different £s from the £s you pay the current interest in?—Yes, but I regard that as an incident of inflation and it does not seem to me a reason for perpetuating a system under which you do in fact erode and deplete existing capital quite apart from creating new capital. There is a difference: the person who invests in a money asset keeps his money liquid in which case he can use his purchasing power at his option. He can invest in equities if he is not satisfied with bonds. On the other hand the person who makes profits has no option. He must risk his liquid assets in fixed form or he does not get business and does not make a profit. There should be some consideration given to that inevitable risk.

3692. What I was wondering was whether anybody had done a sum which showed what he suffered by charging his profits only with depreciation at historic cost and what he made by accounting for his fixed charges, his preference dividends, is depreciated money?—That might be a considerable set-off and it can be dealt with if you use the index numbers to "correct" money profits; you could use it to "correct" money charges.

3693. If you do not find him down on balance then the particular danger of eroding capital through historic costs would not arise?—No, I think that is true.

3694. There is one more subject I wanted your help on, that is your paragraph 23, your suggestions about charging the actual cost of replacement against the revenue of the year in which the replacement takes place?—May I say I am not happy about that. In principle I think it is right and what led me to suggest that at least it should be considered is that it was the practice in the railways until nationalised, and they seem to have been able to carry on that practice. The railways I think developed that practice because they had three characteristics. They were regarded as permanent but I think so is I.C.I. permanent. They were regarded as carrying on replacement quite continuously and there again I think many of the industrial concerns are so large that the work of replacement and repair is quite continuous; but they were regarded also as never changing their purpose and their service and that is why it was easy to treat replacement in the same way as repair; whereas I should be sorry to see any scheme adopted which prevented industrial and commercial concerns diverting their energies from one object to a different object in accordance with the needs of the market and the development of technique.

3695. You have touched on the point I was going to ask about. If I understand you, by this scheme you would really be tying the financial relief obtained to the question whether you had made a replacement or not?—Yes.

3696. And that would not fit in with what you stressed earlier in the paper, that the important thing is for businesses to be able to accumulate free funds to direct as circumstances require?—Yes, so one is thrown back on the index number to "correct".

3697. Apart from the railways, which, as I understood it, had a fairly continuous renewal programme year by year, do you know any industry which in practice adopted the replacement method by way of ascertaining its profits?—I do not personally. I have heard there have been cases and certainly a large number of industries are continuously in process of replacement and repair. It is quite continuous.

3698. Sir Geoffrey Heyworth: The town gas industry and some electricity undertakings.

3699. Mr. Millard Tucker: And a lot of individual companies do. You are not bound to use the depreciation method. You can have a renewals basis if you like.

3700. Chairman: What I was trying to find out is what kind of concern had been suited by using the renewals basis in ascertaining its profits. You mentioned the railways. I know some public utilities do.

3701. Mr. Millard Tucker: I am thinking of a chemical company which did to my knowledge.

3702. I was very interested in your paper. What is the position now in regard to your own recommendations? Is your recommendation that there should be an allowance only if and when plant is replaced?—No. What I would like to substitute for that paragraph is permission to make an additional allowance calculated by the addition required to bring existing depreciation allowances up to replacement costs on which firms can draw.

3703. I want to be clear about this. The present position is this: assume you begin with a piece of plant that costs £100 that lasts ten years so that you lose £10 a year. You will get for tax purposes an allowance of £10 a year against your profits. That £10 represents the amount that is consumed of that capital asset each year and at the end of the 10-year period you should have in your bank £100 with which to replace the asset by another one of the same kind, and then you start again.—Yes.

3704. As I read your paper I understood that in place of the yearly depreciation allowance you would wait until the asset was replaced and then charge the whole cost of replacement, even if it was more than £100, as the railways do, against your then profits and that would not allow you to build up in the 10 years a fund of money. That you do not advocate now, or do you?—I am not sure that it is practicable.

3705. It will not give industry what they are clamouring for at the moment. They are clamouring for an increased annual allowance to put by, wherever it is they keep it, in order that it can emerge again when the time comes for replacing the asset?—Replacing at a higher cost.

3706. Yes, replacing at a higher cost.—They are only alternative methods of doing the same thing.

3707. The renewals basis is open to all taxpayers even now. A taxpayer need not take a depreciation allowance if he does not want to, he may have the renewals basis?—Then I do not understand why he does not take it when his renewals cost him so much more than his depreciation costs.

3708. Having once chosen one method you cannot go to the other method. If he bought a new asset today he can say "I am not going to have a depreciation basis on that asset, I am going to have a renewals basis", but he cannot do that on the existing one because he has already had some depreciation allowance. That would be ideal from the point of view of getting at your true profit but it would not give industry what they are clamouring for, viz., the right to save up.—That is only because when prices begin to go up persistently and rapidly you are unable to change to a renewals basis.

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1709. In paragraph 22 you point out, and I would say rightly point out, that this method of revaluation now is not itself scientific, that if values go up still more you will have to revalue still more, but you will never get the right answer in the end, I quite agree with your view there. What is it you do recommend should be done now?—That an additional allowance for the existing depreciation allowance based on historic cost should be made to bring the funds available for replacement up to the cost of replacement.

1710. First of all with short-lived assets, I can understand you would be able to calculate something for that, but with assets that may be lasting much longer than that, how can it be done from the practical point of view, how are you to measure the additional allowance?—You can do it in two ways. You can do it on the index prices of the year, do it gradually, or you can wait till the end and make it then. I do not think the length of life makes any difference.

1711. Is a rapidly growing scientific age, a mechanical age, one can never be quite sure you are ever going to replace any item of plant with a similar one.—That is the argument for keeping historic cost as one element in the calculation. You want to know what it is that has been put in, but you want an allowance equivalent to the present value of what you put in originally.

1712. The present written down value?—No, the present replacement cost.

1713. The present replacement cost of the same asset?—The cost of putting it in now, and you may use that money to put in a different machine altogether but you do need that special compensation for the using up of a particular machine or whatever it was you put in 20 years ago.

1714. That sort of allowance has got to be policed for the rest of the life of the business to see it is properly applied when the time comes for replacement, but supposing the time never comes or you do not know when it is coming?—Why should that be? After all you are allowing a cost and you do not police other costs.

1715. I was thinking of an example of a multiple baking plant that I had the good fortune to go and look at a little time ago. The ovens and the conveyors which took the dough into the ovens and out again were put in in 1937, and they are still going strong. They have been kept in good repair and there does not seem to be any probability of their being renewed for years except on minor repairs here and there. How do you deal with that? So far as one can see you would be giving the owner of that bakery an allowance on something which he is very likely never going to spend?—In principle you should allow him enough to cover the exhaustion of that machinery in the course of its useful life.

1716. That sort of plant, and so many like that, are kept in such a state of repair that they are never replaced as such, or may not be, for years and years?—You could calculate the useful life. If it is not 20 years it may be 30 years, if it is not 30 years it may be 40 years, or 50 years or 60 years and the annual allowance may be small, but the exhaustion should be treated as cost.

1717. And he also gets the cost of the repairs which keep it in tip-top condition?—The repairs are treated as a cost; I do not see why replacement is not treated as a cost. It is part of the cost of production.

1718. I need not ask many more questions; you have given me an answer to the question that was worrying me, that is, what was your solution. It did not appear to me from your document what the solution was. Now you have given it to me. It is really the same thing which you yourself are condemning in one paragraph. In your paragraph 22 you say this cannot be solved simply by revaluing capital assets at current prices and basing future renewals and replacement allowances on the new values so established?—No, I do not think so. The revaluation of capital assets such as Imperial Chemicals carried out a few years ago may bring them up to date and they know what depreciation will be needed if there is no further rise in prices, but by the time they have to replace much of their equipment prices may have risen further and in that case they will either have to revalue all the assets again, and they might as well start from the original cost and allow for increases of price since then.

1719. What happens if index prices turn the other way, downwards?—Then profits go up, true profits go up.

1720. What would you do about this annual replacement allowance?—Bring it back into profits.

1721. Including all the past allocations?—As much as necessary to allow for the change in the level of prices.

1722. Take an example, supposing an index price having gone up has come back to where it was 10 years before, all that 10 years' extra allowance has to come in?—Yes.

1723. All in one year or gradually?—Gradually, year by year. You do that with stocks. Wool stocks doubled in value between September, 1950, and March, 1951, and they fell to their previous level by September, 1951. These who made up their accounts to March, 1951, showed a profit, those who made up their accounts to September showed a loss.

1724. Stocks are a different matter?—I do not think they are different. I asked a person in the petroleum industry how quickly they amortised their plant, and he said the rule in the industry was four years but they did it in three years to be on the safe side. That is a rapid turnover.

1725. Sir Geoffrey Heyworth: First of all I have one general question. I notice you have said you are confirming your evidence to this particular subject, but would you like to make any observations at all about income tax more generally? If so, we should like to hear them.—Perhaps by restricting my suggestions to two points I might have given a false impression of my views. I would like to say income tax as it has grown up seems to me to be an extremely good tax. I think income is the best index of capacity to pay, so that in principle it is a good tax, and the system of allowances and progressive weights which we have devised adjusts the tax to variations in income and therefore it is practicable to give reasonable equity, and for that reason income tax is not only likely to be, but should be the main tax in any budget. I think it has one defect as I have suggested, that at present it does not, in the case of industrial profits, define true income, and by allowing inadequate depreciation allowances results in treating what is capital as income, but apart from that I think the grievances which most of us feel nearly all spring from the blight of the tax. We did not worry when income tax was 1s. in the £; when it reaches 5s. 6d. in the £, standard rates, all sorts of inequalities and inconveniences force themselves on our attention. In particular, I think it has lost, or is in danger of losing, one of its great advantages, which was simplicity and economy. When I began reading economics the great advantage of direct taxation in the text books was its economy in collection. If you charge against income tax the cost of the services of accountants, tax experts and lawyers and so on which are called for by the collection of tax at the present rate it becomes an extremely expensive tax to the country as a whole. It has ceased to be simple and you get widows and poor people and people not in business forced to go to tax consultants and lawyers to fill up their income tax forms for them whereas it was formerly a straightforward job. Because the amount the Revenue takes from it is so great, we have introduced particularly a profits tax which is a breach of principle since it is discriminating against income from a special source and has introduced a great deal of complication in the administration of the tax. That is one of the losses. I think it is because of its advantages and suitability as a main tax that it ought to be simple. It is not easy to adjust and use for purposes of current economic policy. In principle I think you are bound to have a lag of a year between the income which is taxed and the collection of the tax, so that if you want to influence expenditure I think you must do it more directly by taxes on commodities, or by credit restriction which operates immediately. It is suitable for long term changes like equalising the economic position of people in the country, but there again the simpler it is and the fewer the changes the better; such equalisation should be gradual. But all the difficulties I think spring from the fact that it is so high, and will not pass readily if we are ever able to reduce Government expenditure and so reduce the pressure of the tax.

1726. Should we conclude from that generally that if we had to make recommendations on the basis of preserving the amount of tax, really all we can do is to

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change some old injustices for some new ones. Is not that the scope of our exercise?—I would sacrifice a certain amount of equity for the sake of simplicity.

3727. Have you any suggestions to make where we should seek simplicity, or in what directions we are most likely to be able to find means of sacrificing equity?—Abolition of profits tax, that is the chief thing.

3728. Coming back to this more particular subject, it did seem to me that this approach to find a factual basis, whether in fact industry had been able to maintain its capital intact over the years, is more convincing than these other approaches which merely take samples and play about with them, because we cannot get samples of small businesses and so on; but would you like to comment on how accurate you think the figures in the White Paper are? Are they reasonably accurate, the matter of computation of the figures?—It is difficult for me to comment because they do not go into detail. What I could do if you wish would be to put down quite a few figures derived from the White Paper on savings and the application of savings on which you could ask the Central Statistical Office to comment. They could explain and break down global figures so far as they had the information and answer that question much better than I can.

3729. *Chairman:* If you could produce something for us, it would help us?—It would be only half a sheet of paper but I think it would be enough to get their minds to work. Obviously they find the problem difficult, and if they find the problem difficult, everybody else must, but I think it is the most helpful approach because there are changes in their analysis and the necessary additions. Before four years ago I do not think they distinguished, under the head of profits, stock appreciation, and then they deducted it from profits available for investment and distribution, and at the end of four years that has become a figure so big that it wipes out one-third of the total profits. That is a matter you could discuss with them on the basis of their information better than anyone else. The Government again is the biggest holder of stocks and no one knows what their stocks are. Then again they have to correct . . . I always felt the most doubtful figure in the account was the figure of personal savings. It is doubtful and they warn readers against taking it too literally because to a certain extent it is a residual and may be affected by changes elsewhere, but in the Parliamentary White Paper for 1951 they introduce a correction for the figure they published in 1950. In 1950 they said personal savings were £330 millions. They now say they were only £87 millions in 1950 so obviously there is a wide margin of error in any calculation and I think they are the best people to explain matters. At any rate you can get it out of them.

3730. *Mr. Crick:* You have answered a good many questions about your proposals concerning replacement. I only want to go one step further I think before passing on to general questions. Would your purpose be met by 100 per cent. initial allowances at the option of the business?—I do not think so. That affects the time at which you get the allowance against tax. It does not affect the amount of the allowance. If you had installed a machine costing £1,000 in 1930, and it received an initial allowance of £1,000, the machine may cost you £3,000 to-day, and you have only had £1,000 against it. Actually you could have invested that £1,000 and it would have accumulated at compound interest and gone some way, but it would not have compensated for the rise in prices which led to replacement costs being far in excess of the original cost.

3731. I was under the impression that it would cover that problem because after all, if you are now in 1952 replacing at a cost of £5,000 a machine that cost £2,000 twenty years ago, what you get in effect is an initial allowance now of £5,000—£5,000 plus £2,000.

3732. No, just £5,000.—It is related to the new machine which has its life to live and has to be replaced, and all you are allowing is £5,000, and if prices rise as much during the next twenty years as they have in the past, it will cost you double.

3733. Then you will have an initial allowance of £10,000. I rather thought, subject to the correction of my colleagues, that was the burden of the Tucker Committee's recommendations?—There is another way I can see: if

you have your initial allowance you are at once able to put it into real assets, they would presumably go up with other assets if prices did rise and you would be hedging against inflation. The objection to that is you pay income tax and profits tax on stock appreciation.

3734. Am I right in thinking from your paper that in your view it is desirable at all times and in all phases to encourage the ploughing back of profits?—Not at all times but in times like a generation that follows a Great War.

3735. Irrespective of the phase of the business cycle, if these be such a thing?—Yes.

3736. And you would not then have been agreeable to the removal of initial allowances in the Budget of 1951, you would not have accepted the argument that it would provide some relief from the pressure on the production of capital goods?—I think I probably would and I should be inconsistent, but for this reason: that it is so uncertain whether we shall be able to balance our payments by the end of this year that we are bound I think to take drastic, and possibly in the long run uneconomic, steps to reduce consumption of imports and reduce inflationary pressure, but that I regard as a transient measure. I do not think you can solve the disequilibrium in our balance of payments by reducing capital expenditure in this country, I should think in the long run it would mean we should get into a worse position rather than a better.

3737. Apart from such emergencies you regard the ploughing back of profits as something quite essential to the improvement and expansion of industrial resources?—In an imperfect world it seems to be the biggest incentive to employing capital where it is wanted and I think we want more capital in industry.

3738. Does that lead you to take up any position one way or the other on the taxation of capital gains?—That is taxation of individuals.

3739. And perhaps of companies, but I am thinking primarily of individuals and individual shareholders?—I do not like the proposal to tax capital gains for a number of reasons. If the capital gains simply reflect the influence on security prices of inflation you might argue that the real assets the investor acquires are worth no more and there is no reason to tax them. It is not a real increase in his wealth. They merely represent an inflationary general rise in security values which at some time will give place to a fall and they would be wiped out; what you gain on the rise would be wiped out on the fall. I do not think you can have an inflationary rise in prices continuing indefinitely without provoking such a reaction which wipes out the gains or undermining the currency and compelling such a reconstruction of currency as you had in Germany a few years ago in which all capital gains are wiped out; so I do not think it is a good proposition from the point of view of the Revenue. In application to individuals, I think it would be extraordinarily difficult. I think I heard Mr. Millard Tucker putting some of the difficulties. Obviously if you tax capital gains a person with idle resources will invest in pictures or diamonds and how are you to tax them and how do you value them? How do you tax the capital gain in a private business? Presumably the equity of a private business goes up in the same proportion as the equity of a company which is in the same industry in a period of inflation of trade. I do not know how you would tax that gain, yet why should you tax the company and not the private firm?

3740. The objections concern principally the kind of so-called capital gain which arises from currency inflation, but I am thinking rather of the type of capital gain which arises from the process you have recommended. Let us take this contrast. Suppose I am an ordinary shareholder in a company and I am paid a dividend of 10 per cent. on my shares. I, of course, pay income tax and perhaps surtax on that dividend. Let us suppose, on the other hand, the directors of that company, because they plough back to the fullest possible extent, pay me 5 per cent. and I therefore pay much less in tax; there is no doubt, is there, that I have received an addition to my personal wealth which otherwise could have been accomplished only by setting aside some of my taxed income. What would you say to that kind of case for taxing the sort of capital gains that will be increased under the pressure of the adoption of your recommendation?—So far as income tax is concerned it will pay tax.

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3741. In the hands of the company, not in the hands of the shareholders?—So long as it remains with the company it escapes taxation. At present it pays profits tax. Your company is forcing you to save. You could agitate with them to increase the dividends. On the other hand most investors accept that. They prefer the addition. I do not think they have a grievance.

3742. There would not be much chance of success?—I do not think so. I think on the whole I should welcome that arrangement as a little more saving which otherwise would not arise.

3743. If you continue this process of ploughing back on a very large scale and very extensively and very persistently, does it not mean that you foster the entrenchment of a large, powerful and already well established undertaking as against the small and up and coming concern?—It is a matter of degree. If a large company is conservative in its distribution and does strengthen its position, on the whole I think it is desirable it should be allowed to expand its operations. It will be a management one can trust with society's resources. The small company has the same opportunity, and I should have thought that on the whole it distributed less than the big company, a smaller proportion of its savings.

3744. My question is whether it has the same opportunity inherent in its position? I do not know. My impression is that the owners of small businesses are as accustomed as they can be, everything goes back into the business, and over a period they save at least as high a proportion as companies with a large body of shareholders dare save.

3745. You are thinking of the small private company as distinct from the unincorporated business?—Yes.

3746. Professor Hicks: I would like to ask one question. When replying to Sir Geoffrey Heyworth just now you stressed very much the extent to which all these troubles with which we are so much concerned are due to the high rates of taxation now imposed. I would like to ask whether you consider the reforms in the definition of taxable income on a replacement cost line are really more necessary or less necessary than reduction in the rate of tax?—I think more necessary. My general position is that we have to face in this country a sort of reorientation of business such as we had to face in 1922 because we have not yet emerged from the re-starting boom which follows a war. We do not know how much Indian and Japanese competition are going to mean. We have to face the sort of reorientation we had in the period from 1922 to 1939. We need all the capital we can get and we certainly ought to stop the erosion of capital where it is being used effectively in an organised way.

3747. Supposing the alternatives were the use of a given amount of money either in making the replacement cost adjustment or in a similar reduction in tax, so that business in general is going to get the same sum in tax reduction in either case. Would not that stop the erosion whichever way it was done?—You mean reduction in the standard rate?

3748. Yes.—Given so . . .

3749. Or the abolition of profits tax?—In that case I think my reply is (a) provide for replacement costs, (b) reduce profits tax, (c) reduce the general rate.

3750. There is an argument on the other side and I should like to know how much weight you would give to it, that the change in the definition of income would never have the effect of handing over to industry a certain lump sum or in taking from industry a certain lump sum, whereas the other method would act on the marginal rate of profit and might be more effective in encouraging investment to go into the right lines than a lump sum. Do you attach any weight to that?—I think I would, yes. I prefer the method of dealing with replacement costs first because that would apply to industrial income specifically, whilst an adjustment in the general rate would be spread over the whole income. That is my reason. If you get a more precise adjustment of my relief you give to industrial income it is wholly desirable.

3751. From that point of view the reduction in the profits tax, which would apply to industrial income, would be the first?—Yes.

3752. Mr. Kaidor: There are a number of questions which arise on the earlier discussion to-day that I should like to ask you about. The first is the business of the erosion of capital which came up a number of times. In answer to questions by the Chairman before lunch you said you think a certain amount of erosion in the real industrial capital of the country has been taking place or is taking place?—That is quite possible.

3753. You base that on what?—On Tables 29 and 30 in the 1951 White Paper.* In Table 30 the total capital expenditure on fixed assets is £1,577 millions; in Table 29, line 8, provision for depreciation by enterprises is £1,022 millions of which £260 millions, that is in another table, is initial allowances leaving £762 millions. It is possible to make a division by the aid of Table 31 between non-industrial and industrial expenditure using industry in the wide sense to include agriculture. If you take only housing and public building you get £420 millions which is not industrial leaving £1,177 millions, and what I suggested was that if you take the figure of depreciation allowances for enterprises at £762 millions and raise it to allow for the fact that that figure is calculated on historic cost and current replacement is at current cost, there will not be much difference between the two figures.

3754. I think I ought to add to this if I may, though I am not sure that I can put it in the form of a question. I am afraid the Central Statistical Office did not break down this figure of £762 millions for depreciation which does contain an awful lot of different things; but the Statistics and Intelligence Branch of the Inland Revenue has supplied us with more detailed figures from which it appears that annual allowances on plant and machinery were only £130 millions before the war and should now amount to about £244 millions. It is this sum of roughly £250 millions that you ought to compare with the annual expenditure on plant and machinery in order to form an opinion how that annual expenditure on plant and machinery is related to depreciation. Also when you say that this was on historic cost you would have to allow for the fact that a great deal of the allowances now relate to expenditure undertaken since the war. My own estimate is that on pre-war prices the present allowances should only amount to £150 millions instead of £250 millions, therefore the correction for the change in prices is not nearly as large as would appear if you were to take the rise in prices since the war.—Do I understand you, the figure to compare with £250 millions post-war values is £1,377 millions?

3755. No, I would say to make this comparable you would have to deduct all expenditure on building from the figure of £1,377 millions and relate it to expenditure on plant and machinery. Turning back to Table 30 I should have thought it is the figure for plant and machinery and passenger cars, £641 millions, which is more comparable to this annual allowance of £250 millions.

3756. Professor Hicks: Might I ask whether it would not be convenient for the information of other members and also perhaps for the record if Mr. Kaidor stated at this point what were the other items included in the £762 millions depreciation allowance apart from industrial depreciation allowance?

3757. Chairman: Which table is the figure of £762 millions in?

3758. Mr. Kaidor: This was a residual figure calculated by Sir Henry; you can get it in the White Paper by taking from item 8 in Table 29 the amount of initial allowances given in 1950 shown in item 16 of Table 6. But the figure there for other allowances is £264 millions.—No. The figure I quoted is item 10 (b) of Table 2. The £264 millions may include such things as depreciation on public buildings.

3759. I gather from the Inland Revenue that this is rather an omnibus item which includes all sorts of things, of which annual allowances of plant and machinery alone were the figures mentioned to us. In addition it contains agriculture, the nationalised industries, concerns operating overseas, initial allowances, allowances on industrial buildings, balancing allowances and allowances

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for scientific research and patents. I am afraid I do not have a complete reconciliation of these two figures; no doubt it can be supplied.

3760. *Mr. Kaldor:* Quite apart from this question, you would not say, leaving figures and looking at it in a general way, that the amount of real investment in industry, the amount spent on plant and machinery and factory buildings now in the process of being created is less than used to be the case in the years before the war?—No.

3761. I think there has been a considerable increase as compared to pre-war years?—Yes, a large part is replacement; the need for replacement is exceptionally large.

3762. In other words, what you are saying is that we are overtaking arrears accumulated during the war years when ordinarily renewals and replacements were not taking place?—Yes, and war-time expansion, it is an exceptional change.

3763. Our industrial capital is probably not much larger than it was before the war?—That is my impression.

3764. But having once overtaken the arrears, if we are to continue making investments in plant and machinery in industrial buildings at the present rate, then you would agree we should be increasing our real capital faster than we were increasing it in the interim period?—I think that is probable, yes.

3765. So that all your fears concerning the erosion of real capital really relate to the question whether the present rate of real investment in industry can be maintained. If it were maintained you would have no fears of such erosion taking place?—I would have to look at the increase of output of industry. I have not got that in my mind.

3766. Industrial investment is largely a matter of the output of the steel and engineering industries and buildings?—Since the war it has been very largely a matter of reconstituting stocks, which has been enormous.

3767. Yes, but assuming that process of reconstituting stocks has now been more or less completed, real capital accumulation involved using the products of the steel and engineering industries for the purposes of enlarging industrial capacity at home.—You do not fear any running down of the railway system? Do you think that has been adequately kept up?

3768. I am not sure. The question I was coming to was this: we have had a certain rate of real investment in recent years in fixed assets. (I am not worrying about stocks any more.) We may have to reduce this now for two reasons, one is rearmament and the other is the need for increased exports. Apart from these, if we could maintain the actual rate of investment then I do not think there would be much fear in industry as a whole that erosion of capital would take place. Some industries, like railways, may not maintain their capital, perhaps they ought not to because they are obsolete, but other industries would be expanding all the faster.—I think that follows. I am not sure how soon we shall be relieved from the necessity of larger exports, and I am not sure, though it is difficult to check this, of the weight of capital investment before the war.

3769. I am entirely with you. Our capital investment ought to be as high as possible and it should be increased. The question I am asking is how can this be

done given our present situation unless we manage to transfer resources from the consumption industries and produce more steel and have an enlarged capacity in engineering? You would agree?—Yes.

3770. There is no other way we can do it?—No.

3771. If you look at it from the financial requirements of having more investment, is not the most important matter to reduce consumption, is it not far more important, in order to provide industry with finance, to reduce consumption than relieve them of taxation in respect of profits?—So that they can draw additional capital from the market do you mean?

3772. Unless resources are released from consumption to investment, investment in fact would not be increased?—Yes.

3773. And if investment resources are there, does it not follow the financial resources will be there too in one way or the other?—Yes.

3774. Someone will be able to provide the money if the resources are there?—You mean the fundamental condition that is dangerous is a disproportionate amount of the national resources applied to consumption?

3775. Yes. If we wish to have increased investment the tax reforms that should be pressed for are reforms that are capable of reducing consumption. That is the only way in which we can have an increase in investment, and unless we manage to reduce consumption the job cannot be done. It may be that our present level of investment is inadequate even to maintain our real capital stock but there is nothing else we can do in order to change the situation.—I think that is right.

3776. Does it not follow that in any tax reform the overriding question that we ought to keep in mind is whether it will have the effect of increasing or reducing consumption? That is far more important than any other consideration.—I think that is the Treasury's problem.

3777. I was wondering whether there was a difference between us; I am very glad to see there is not. As far as the question of the effects of depreciation allowances and goodwill is concerned, the problem would only arise if it were found that there are surplus resources in the investment goods industries that are not utilised by industry, it is then you can say for one reason or another industry has not enough financial resources to undertake all the investment that it is possible to undertake?—Yes.

3778. And if that situation were to arise, then giving industry more money by way of lower interest rates, increased credit facilities, higher initial allowances, lower taxation of profits are on exactly the same level in remedying the situation. It does not matter how industry gets the money if they get it and spend it?—I think there is one complication, you cannot look simply at the investment in industry. We can increase the exports, we might get additional equipment from America, that is the only qualification.

3779. Again it is a question of reducing consumption, increasing exports?—Yes.

3780. *Chairman:* Thank you very much for your helpful evidence. At your leisure you will let us have a short note on the kind of pointers you spoke of when answering Sir Geoffrey Heyworth?—Yes.

The witness withdrew.

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Mr. C. J. GEDDES, C.B.E., Mr. L. MURRAY and Mr. F. JONES

[Continued]

Mr. C. J. GEDDES, C.B.E., Mr. L. MURRAY and Mr. F. JONES, on behalf of the Trades Union Congress; called and examined.

EXTRACT FROM MEMORANDUM SUBMITTED BY THE TRADES UNION CONGRESS

B. PARTICULAR MATTERS

Introduction

93. This section of the Evidence submitted by the Trades Union Congress is supplementary to its previous Evidence on General Social and Economic Questions. It deals with certain of the particular questions listed in Part B. of the Commission's Heads of Evidence.

Question 5 (b) *Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?*

Gambling profits

94. There is, we consider, a good case on both social and fiscal grounds for taxing gambling profits. The social aspects were reviewed by the Royal Commission on Betting, who stated in their Report (para. 209) that they saw "as reason on social grounds why the State should not secure revenue from expenditure on gambling. Indeed, we think it in principle reasonable that all commercial forms of gambling should make a contribution, as do other forms of amusement and indulgence." We agree with this point of view, and are of the opinion that it is supported by fiscal considerations, which the Royal Commission on Betting excluded from their purview.

95. Profits from betting, lotteries and gaming often represent a source of current income. The fiscal state of the present law is illustrated by the Court decision that private betting from a home address is not liable to taxation even if it constitutes the bettor's sole means of livelihood. While bookmakers' profits are assessable to tax, and their losses admissible as deductions, these losses become gains to the recipient but escape the tax not under the present law. Moreover, this fact has been seized upon by would-be tax evaders, who can plead that undisclosed gains in fact are the proceeds of betting, etc. transactions: this loophole in the law can only be stopped by making these profits assessable to tax.

96. No doubt the Royal Commission will have in mind, when considering this question, the objections which might be raised by sections of the community who are opposed to the State benefiting by participating, in some sense, in gambling transactions. We recognise the force of these objections, but hold that they are outweighed by the considered views of the Royal Commission on Betting and by the probability that on balance the imposition of a tax would reduce this activity.

97. We therefore suggest that gains from lotteries, betting and gaming should be treated as a special category of short-term capital gains (see below paragraphs 110 to 112), and that the taxpayer should be allowed (subject to a time limit) to set off net annual losses against future gains from these activities. We recognise that it would be necessary, on the grounds of administrative convenience, to set a minimum limit below which annual net gains (and losses) from gambling would be disregarded.

Other capital gains

110. Under the present tax law capital gains or profits arising from transactions which do not form a part of the ordinary business of the person making them are exempted from tax. The principle which appears to underlie this practice is that if such gains were taxed it would constitute taxing capital, and would go beyond the intention of the Income Tax Act, 1913, which is restricted to bringing into tax the revenue derived from capital.

111. We are not, of course, concerned here with capital profits which are already recognised by the law as constituting income and are taxed accordingly. It is, however, our opinion that it is inequitable to levy income tax (and possibly sur-tax) on, say, the profit made by a full-time dealer in shares from a remunerative transaction, whilst an individual who benefits to the same extent from a similar transaction escapes with the payment of a small

stamp duty. When we express our concern at the tax-free profits made by individuals and companies from the purchase and sale of assets outside the ambit of their normal business or trade, we are reflecting the increasingly critical attitude towards this state of affairs taken up by large sections of trade unionists in recent years.

112. There can be no doubt that the opportunity to derive untaxed profits from such practices as the short term speculative buying and selling of shares, house-property and other assets, and the conversion of private companies into public companies, provide grounds for criticism of the existing law. They are excluded from taxation on the purely technical grounds of a legal definition which does not correspond to the facts of the situation. The facts are that the object of undertaking these activities is often to secure untaxed income, that the rewards of these activities are treated by the recipients as spendable income and that by no stretch of the imagination can such expenditure be regarded as running down capital to maintain life.

113. These facts in themselves argue the need for tackling this problem by the introduction of a tax on capital gains, as the 1919 Royal Commission on the Income Tax recognised in their Report (para. 84-94), and the case for introducing such a tax can be further supported on several counts.

114. In the first place, such capital profits are frequently derived not from the exercise of productive skill and effort but from the ability to exploit the situation of the market—as in the case of industrial shares. The possibility of securing these gains (perhaps by influencing the market) attracts the use of capital which might otherwise be used in more socially desirable investments. The test of the desirability of an investment thus becomes whether it will enable the investor to secure an advantage from a short term appreciation in value (even at the expense—borne by someone else—of a subsequent diminution) rather than whether it will provide a useful service to the community and a long term reward to the investor.

115. In the second place, the rewards to be gained from speculation are likely to add to the pressure of inflation. *Speculative investment*, which leads to the creation of real wealth, has a different purpose and different economic effects than has purely speculative short term investment whose object is to secure quick returns in the form of capital gains.

116. In the third place, it is not only speculators who benefit from the fact that capital gains are free of tax. Firms are encouraged to put profits in reserve by a rebate of 40 per cent. of the Profits Tax, but the very fact of a strengthening their reserves is bound to be reflected in a higher value of their shares or the possibility of making bonus issues. Shareholders can therefore realise part of their holdings at an increased value, with some confidence that their current income will be maintained by the pressure for a higher nominal dividend by those who have bought shares at the higher market value. The possibility of doing this, of course, entered in conditions of full employment.

117. We would emphasize that what we are advocating is not a tax on capital, which is not within the terms of reference of the Royal Commission, but a tax on income derived from capital as capital. The type which is at present masquerading as capital. The type of gains we have in mind are those which are classified as gains for the purpose of the U.S. Federal Income Tax. These all property should be classed as capital assets, except that which is used or held for sale in a trade or business, and gains from the sale of such assets should (subject to what is said below) be assessed to tax.

118. The tax should operate after an appointed day specified by legislation, and should be levied on the gain which accrued between that appointed day and the date on which the asset was sold. On the one hand, this

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[Continued]

would avoid any hardship which might arise where an individual had bought an asset some considerable time before the appointed day without knowing that his transaction would, at some future date, become liable to tax; and it would, on the other hand, prevent speculators from realising an untaxed capital gain which accrued during a period when, merely because of a difference in the date of purchase, gains were accruing which would eventually become liable to tax.

119. To be equitable, a capital gains tax should distinguish between the speculator and the bona fide long term investor. Capital gains derived from the sale of assets held for a short period should therefore be taxed more heavily than gains from the sale of assets held for a long period. This has been the practice in the United States, where a profit resulting from the sale of a capital asset held for less than six months has been taxed, twice as heavily as when it is held for more than six months. Capital losses should also, as in the United States, be deductible from capital gains to arrive at net taxable capital gains, but net capital losses should not be deductible from ordinary income to arrive at net taxable income. Capital gains should, indeed, be treated as a special class of income and should not be consolidated with ordinary income for tax purposes: the rate of tax to be levied should be determined independently of the standard rate of income tax. We consider, however, that it should be possible to carry forward net capital losses

(subject to a time limit) and set them against future capital gains for tax purposes.

120. It must be recognised that there are possibilities of evasion in connection with this type of capital gains tax. Perhaps the main possibility arises from the fact that speculators may hold on to assets which are appreciating in value long enough to avoid the higher rate of tax, whilst at the same time increasing their spendable income by selling assets which have not appreciated. This may account in part for the relatively small yield of the capital gains tax in the United States and suggests that the minimum period which assets have to be held to avoid the higher rate of tax should be longer than that in force in the United States. On the other hand, by holding on to such assets speculators take the risk that the gains will never be realised. Thus even if the yield of the tax is not large it may serve the purpose of discouraging speculation for tax free gains.

121. We recognise also that administrative problems would be set by the introduction of such a tax, and it would be necessary, at least in the initial stages, to limit the scope of the tax. From an administrative point of view, therefore, it would probably be desirable to fix a minimum level below which net capital gains would not be taxable (nor, conversely, net capital losses carried forward).

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SUPPLEMENTARY MEMORANDUM SUBMITTED BY THE TRADES UNION CONGRESS

THE EFFECTS OF INFLATION ON INDUSTRIAL CAPITAL RESOURCES

Part I—Comments on the F.B.I. Case Study

[The F.B.I. Case Study will be published in the Minutes of Evidence for the Seventeenth Day.]

1. The purpose of the pamphlet issued by the Federation of British Industries on "The effects of inflation on industrial capital resources" is to back up with statistical evidence the allegation that the:

"... combination of inflation and high taxation, coupled with the deficiencies of the existing method of computing depreciation allowances, has seriously impaired the capacity of industrial undertakings to maintain their capital resources and to finance essential expansion." (Foreword.)

2. The objects of Part I of this document are, first, to examine whether the statistical analysis which the F.B.I. have put forward is in fact representative of the position of British manufacturing industry and, second, to discuss whether, if it is representative, the F.B.I. are justified in drawing the conclusions set out in Part III of their pamphlet.

Basis of the Survey

3. The basis of the F.B.I. survey was a questionnaire sent to certain of their member companies. Figures based on the replies to the questionnaire are given in Appendices A and B of the pamphlet, but the questionnaire itself is not included, nor is a list of the 80 companies which are covered by these Appendices.

4. As a check on the F.B.I. figures we have taken a sample of the balance sheets of 30 manufacturing companies included in the series of company memoranda issued by Moody's Services Ltd.* This sample is referred to in this document as the Moody survey. It should be emphasised that the sample was drawn completely at random. No attempt was made to select particular types or sizes of company, and in fact the issued capital of the companies covered by the survey ranged from £10,000 to £4½ millions in 1949.

* See Appendix.

Is the survey representative?

5. The first question to be considered is whether the F.B.I. survey is representative of manufacturing industry generally. The F.B.I. themselves do not claim (para. 9†) that the companies which replied to the questionnaire are "completely representative of industry as a whole", nor do they claim complete statistical accuracy for their estimates. It is regrettable that the F.B.I. should have thought it appropriate even to publicise these results as a "case-study", carrying the implication that they are in some sense typical of a wider number.

6. This question can be looked at from another angle—the average size of the companies which replied. In 1949 each of the firms covered by the F.B.I. survey had, on average, no less than £10 million worth of net assets and 3,500 employees. Yet the Ministry of Labour estimate that manufacturing establishments employing more than 10 persons at the end of 1949 had on average about 125 employees.†

7. Comparative figures of employment for the firms covered by the Moody survey are not available, but the average value of their net assets in 1949 was about £370,000, compared with £10 million for the F.B.I. firms. We do not claim that the firms covered by our survey are representative of the whole of British manufacturing industry, although any case-study of these firms would obviously come nearer to giving a statistically representative picture of British industry.

8. The answer to the first question, therefore, is that the F.B.I. survey cannot be taken to be representative of manufacturing industry generally. The F.B.I. cannot claim that the conclusions which they draw in Part III of their study relate to anything but the 80 firms which replied to the questionnaire.

Comparison of real capital assets

9. The first question posed by the F.B.I. (in paragraph 10) is how the 1949 capital assets of the companies cov-

* Unless otherwise stated, all references are to paragraphs of the F.B.I. pamphlet.

† Ministry of Labour Gazette, June, 1950.

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[Continued]

owned compared in real terms with those which they possessed in 1938. The figures on which they base their conclusions are given in paragraph 12 of their pamphlet. Comparable figures based on the Moody survey are as follows:—

TABLE A

Assets	1938 £'000	1949 £'000	Increase over 1938 £'000
Buildings, plant and machinery	15,132	34,900	9,748
Net current assets	13,276	41,730	28,454
	28,408	66,630	38,222

10. *Fixed assets.* To revalue 1938 assets at 1949 prices the F.B.I. use the U.S. Economic Co-operation Administration (E.C.A.) index (paragraphs 13-14). This index was derived by E.C.A. from a Capital Goods Price Index produced by D. Seers (see *Inf. Inst. of Stats. Bulletin*, June, 1949), the index numbers for 1929-1949 being interpolated by E.C.A. The F.B.I. do not justify the use of this particular index, yet it probably exaggerates the rise in the costs of fixed assets. The indices of the costs of fixed assets for 1947-49 calculated by the U.N. Economic Commission for Europe (E.C.E.) in the "Economic Survey for Europe in 1949" (p. 236) were 212, 224 and 229 (1938 = 100), as compared with the E.C.A. figures of 218, 240 and 249.

11. If the F.B.I. had based their index on the E.C.E. estimates it would of course have the effect of reducing the value of 1938 fixed assets at 1949 values; it would also reduce, but not by so much, the 1949 composite book value at 1949 prices (see paragraphs 15-17): the net result of these two changes would be to enhance the value of the firms' existing assets as compared with their 1938 assets. In the following section, however, we have deliberately used the E.C.A. index in order to present the F.B.I.'s case as favourably to them as possible.

12. Using the E.C.A. index the F.B.I. show that £127 million of fixed assets at 1938 prices were worth £315 million at 1949 prices. Applying this index to our own figures, £15,152,000 of assets at 1938 prices were worth £37,735,000 at 1949 prices. Both these calculations assume that the 1938 book values represented the actual value of the assets then in use.

13. The next step is to find out the real value (as compared with the book value) of the 1949 assets. Using the method described in paragraphs 15-17 of their document (and illustrated in their Appendix B) the F.B.I. estimate that this figure is £304 million. Using the alternative method described in paragraphs 19-20 of their document the F.B.I. estimate that the real value of the 1949 assets (on a replacement cost basis) was £356 million.

14. The first method therefore shows a reduction in the real value of these firms' fixed assets of 34 per cent.; the second methods shows an increase of 13 per cent. The difference is a marked one, and demands further investigation. Before doing this, however, it should be stated that we have insufficient information available so far to carry out similar calculations in relation to the firms covered by the Moody survey.

15. A very rough check can be made by assuming that the average cost of replacing their assets during this period has been broadly the same for the Moody firms as for the F.B.I. firms. On this admittedly questionable assumption, and allowing for the fact that (on the basis taken in paragraphs 15-17) an apparent expansion in money terms of 55 per cent. concealed a real contraction in physical terms of 34 per cent., the Moody firms expanded their assets by about 2 per cent. to £384 million (see Table C below). If, on the other hand, we were to assume that the rate of net annual expenditure and depreciation of the Moody firms was broadly the same as that on which the F.B.I. firms based their alternative approach (see paragraphs 19-20), and that therefore the Moody firms increased their real assets by 13 per cent.,

their 1949 assets at 1949 real values would be worth about £424 million (see Table E below). Whilst it would be unrealistic to put our calculations forward as firm estimates, it is, to say the least, probable that the value of the Moody firms' real assets in 1949 was greater than their value in 1938.

16. To revert to the alternative figures put forward by the F.B.I., they state (in their footnote on page 9) that they favour the one reached by the first method since the second method suffers from the fact that "it was not possible to ensure that a uniform method of calculation was adopted". This preference is debatable. In the first place, for the reasons given in paragraph 10 above, the E.C.A. index is of doubtful validity. In the second place, even if the E.C.A. index was accepted as being accurate, it is a generalised index and there is no evidence that the rise in the investment costs of these 80 firms has followed the average pattern. Thus it at least appears to be an open question whether the firms' own calculations are less accurate for this purpose than is the E.C.A. index. The choice of basis does, of course, make a considerable difference to the picture. It would obviously be in the F.B.I.'s interest, if they are seeking to prove that these firms have not maintained fixed assets intact, to show that the first basis was the better one but they cannot claim that they have shown this.

17. *Current assets.* The revaluation of current assets is simpler. Assuming that the 1949 book value of current assets is equivalent to their real value, the F.B.I. estimate (para. 21) that between 1938 and 1949 the real value of current assets rose by £36 million, or 94 per cent. On the same basis the real value of the current assets of the firms covered by the Moody survey rose by £9,735,000 or by over 30 per cent. This is a considerable difference, and part of it may possibly be due to a difference of approach in definition, in that we have used the classification of "liquid" and "fixed" assets used by Moody's in their company sheets, and we may therefore have included in liquid assets some stocks (e.g., of tools) which the F.B.I. would define as fixed assets. Such differences in definition, however, could only lead to a comparatively small error, and, in any case, they disappear when fixed and liquid assets are dealt with as a whole, as is done in the following paragraphs.

Fixed and current assets

18. Taking the lower of the F.B.I.'s estimates of fixed assets (i.e., the one given in their paragraph 17) the following is their estimate of the change in value of all assets:

TABLE B

Assets	1938 assets revalued at 1949 prices £ million	1949 assets at 1949 real values £ million	Increase over 1938 £ million	Per cent.
Buildings, plant and machinery	315	304	- 11	- 34
Net current assets	278	414	+ 36	+ 94
	693	718	+ 25	+ 34

Using the same assumption for changes in fixed assets, Table C shows the change in value of all assets of the Moody firms:

TABLE C

Assets	1938 assets revalued at 1949 prices £'000	1949 assets at 1949 real values £'000	Increase over 1938 £'000	Per cent.
Buildings, plant and machinery	37,728	36,573	845	2
Net current assets	31,985	41,730	9,735	30
	69,713	80,303	10,580	15

On the alternative assumption of the F.B.I. that the firms expanded their real fixed assets by 13 per cent.,

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(see paragraph 19). Tables D and E compare the experience of the F.B.I. firms and the Moody firms respectively:

TABLE D

Assets	1938 assets revealed at 1949 prices £ million	1949 assets at 1949 real values £ million	Increases over 1938 £ million Per cent.	
Buildings, plant and machinery ...	315	336	+ 41	+ 13
Net current assets ...	378	414	+ 36	+ 9½
	693	750	+ 57	+ 8½

TABLE E

Assets	1938 assets revealed at 1949 prices £'000	1949 assets at 1949 real values £'000	Increases over 1938 £'000 Per cent.	
Buildings, plant and machinery ...	37,728	42,639	4,911	13
Net current assets ...	31,965	41,750	9,785	30
	69,723	84,389	14,666	21

Taken as a whole, therefore, the real assets of the firms covered by the Moody survey were 15·21 per cent. higher in 1949 than they were in 1938, while those of the firms covered by the F.B.I. survey were 31·11 per cent. higher. It may be repeated here that we have consistently taken the assumptions which are most favourable to the F.B.I.'s case—i.e., which are less likely to show a rise in the real value of assets.

19. Taken by themselves these figures prove nothing, but they do emphasise the very limited value of the F.B.I.'s analysis. If the F.B.I. had taken a different 80 firms they would probably have arrived at a conclusion quite different from that reached in their case-study.

Financing of assets

20. The next question to which the F.B.I. turn is how the extra money to finance this increase in the cash value of assets was found, and in particular whether the firms managed to maintain capital intact without resorting to outside sources of financing. Table F sets out the ways in which the extra money was found by (a) the F.B.I. firms, and (b) the firms covered by the Moody survey:

TABLE F

Financed by:	(a) F.B.I. firms		(b) "Moody" firms	
	£ million	Per cent.	£'000	Per cent.
Share issues (including share premiums) ...	52	14·4	6,757	17·7
Borrowing (short and long term) ...	69	16·6	609	1·6
Increase in tax reserves and deferred liabilities	55	15·2	5,221	13·6
Changes in minority interests	— 4	— 1·2	289	0·3
	163	45·0	12,876	33·7
Profits retained in the business	199	55·0	25,385	66·3
	362	100·0	38,261	100·0

21. Table G brings together the above calculations to show how far the F.B.I. firms and the Moody firms respectively were able to maintain intact their 1938 real capital out of profits. How far they were able to do this depends, as the F.B.I. point out in paragraph 24, on what assumption is made on changes in the value of fixed assets; the columns marked (a) and (b) in Table G are the result respectively of calculations based on paragraphs 15-17 and paragraphs 19-20 of the F.B.I. pamphlet.

TABLE G

	F.B.I. £ million		Moody £'000	
Amount necessary to maintain: Net current assets	221		18,729	
	(a)	(b)	(a)	(b)
Fixed assets ...	70	47	9,391	6,911
Total assets ...	291	268	27,910	25,330
Profits retained in the business	199		25,385	
	(a)	(b)	(a)	(b)
Proportion of assets maintained out of profits	68·4		91·0	

On the assumptions used by the F.B.I., therefore, the firms covered by their survey could only provide from profits enough money to maintain intact between two-thirds and three-quarters of their 1938 capital; on the other hand the firms covered by the Moody survey provided out of profits between nine-tenths and the whole of the money needed. We would, in this connection, direct the Royal Commission's attention to the very large increases in the tax reserves of both groups of companies; if there is any element of over-provision (on grounds of prudence) here, this is bound to distort the picture.

22. We would stress that the purpose of the comparison we have made is not to prove that the F.B.I. figures are right or wrong, but to discover whether generalised conclusions relating to British manufacturing industry can validly be drawn from them. Our own survey shows that such conclusions cannot be drawn: even allowing for reasonable margins of error, our calculation based rigidly on the F.B.I.'s approach shows that broadly speaking these firms saved enough from their own profits to maintain capital intact.

23. Other facts, however, would have to be taken into account before any definite answer could be given to the question whether industry had suffered from inflation and the level of taxation.

24. First, the F.B.I. do not provide figures of total profits or of distributed profits for these firms, and we are therefore unable to judge whether they are right in their assertion (paragraph 26) that:

"Any suggestion that the companies could have avoided seeking outside finance by reducing the amount of profits distributed ... is not borne out by the facts."

This omission is remarkable since the F.B.I. must have had these figures in order to work out the percentages of distributed and undistributed profits quoted in paragraph 26 of their pamphlet—percentages which, without knowing what sums they represent, are quite meaningless. It is not sufficient for the F.B.I. to say, as they do, that "data before 1945 (are) not available"; the actual figures are available in the annual profit and loss accounts of these firms. This omission must, rightly or wrongly, create some suspicion that the figures of profits distributed by these companies between 1938 and 1949 would have weakened the F.B.I.'s case.

25. Second, although the F.B.I. show that profits retained in the business were not in themselves sufficient to cover the cost of maintaining intact the capital of their 80 firms, the fact remains that the real value of the assets actually owned by these firms in 1949 was higher than their assets in 1938. This, of course, is even more true of the firms covered by the Moody survey.

26. Third, while agreeing that firms do not like going outside their own businesses to raise capital, there is no reason to claim that industry, or even particular firms, should in the nature of things never be obliged to do so. It appears practically certain that the firms covered by our survey saved enough from their own profits to maintain their real assets intact, and only raised capital from outside for purposes of expansion.

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27. Finally, it should be pointed out that, whereas between 1938 and 1945 the F.B.I. firms saved \$66 million out of profits, between 1945 and 1949 they saved \$133 million: the annual rate of accumulation in these last four years was three and a half times as high as in the first seven—and this rate has probably continued.

Adaptability of capital resources

28. The next question considered by the F.B.I. is whether the capital resources of these companies were adequate in 1949 as compared with 1938. Figures which would enable a comparison to be made with the firms covered by our own survey are not available, and so the F.B.I.'s case can only be judged on its own merits.

29. Notwithstanding the alleged deterioration in the financial position of these firms, they produced at least one-third more in 1949 than in 1938. Employment also rose by a third. The F.B.I.'s statement (paragraph 28) that:

"In 1938 fixed assets per employee in the eighty companies averaged \$628 valued at 1949 prices, whereas in 1949 the figure was \$449."

depends on which basis is used for the valuation of 1938 assets. Their figure of \$449 (although the F.B.I. do not make it clear) is calculated on the first basis (see paragraph 13 above and paragraph 17 of their document). If the second basis (see paragraph 13 above and paragraph 19 of their document) was taken, the 1949 figure would be \$525. If this latter figure is taken—and no adequate reason is given why it should not be—the possibility, largely discounted by the F.B.I., that the higher production is due to the more intensive use of equipment becomes more likely. In any event, the fact remains that production in 1949 was one-third higher than in 1938, even with less capital investment per employee. The conclusion to be drawn from this is that the efficiency of plant and/or of utilisation of plant have increased, or that in 1938 these firms had capital equipment standing idle.

30. To return to the figures actually used by the F.B.I., it is in some ways unsatisfactory to compare 1938 with 1949 since this period includes two separate phases—the running-down of capital during the war years and its rebuilding since the war. The figures given in Appendix B of the F.B.I. pamphlet show that these firms have been able to make good in four years almost the whole of the running-down of capital in the previous seven years: another way of putting it is to say that in the years 1945-49 these firms were able to increase the net value of fixed assets per person employed by nearly 13 per cent. (even allowing for increased employment). This trend would probably be found to have continued since 1949.

31. As for depreciation provisions, it should be pointed out that, even if the F.B.I. are right in claiming (in para. 32 of their document) that their firms will have to put aside \$17½ million a year for capital replacement in addition to their normal depreciation charges, this will only mean that firms are appropriating about 2 per cent. of the value of their annual turnover to this purpose—about the same figure as in 1938.

32. Finally, in relation to the depletion of circulating capital referred to in para. 33 of the F.B.I. document, no comparative figures are available for the firms covered by our survey with the exception of that for cash. Whereas the F.B.I. firms' cash was (after adjusting for rises in prices) 30 per cent. lower, the cash of the firms covered by our survey was about 17 per cent. higher. In any event, too much importance can be attached to this question of liquidity. The degree of liquidity considered desirable in 1938 may be unnecessary in conditions of full employment.

Conclusions

33. The following conclusions are therefore to be drawn from this comparative survey:

(a) The firms on which the F.B.I. have based their pamphlet are not representative of British manufacturing industry generally. Any conclusions which are drawn from their experience relate solely to these 80 firms and to nothing else.

(b) When analysed on assumptions which are markedly favourable to the thesis the F.B.I. are trying to prove, the experience of another group of firms not only does not bear out the F.B.I.'s allegations but in some respects directly contradicts them.

(c) Notwithstanding their alleged financial difficulties the F.B.I. group of firms were producing far more in 1949 than in 1938—probably because of full employment. This, on their own evidence, is a tribute to the productivity of the workers employed by the firms.

(d) The F.B.I.'s analysis obscures the fact that the period covered includes six years of war during which the whole community suffered. Their complaint is that their firms were unable in four difficult post-war years to replace from their own profits all the assets run down during the war. The fact that no figures are given beyond 1949 is regrettable since a markedly favourable trend was then apparent.

(e) The omission of any figures relating to the distributed profits of these firms makes it impossible to judge whether—even if we accepted every other conclusion—the firms are justified in directing their complaints against inflation and high taxation.

34. Finally we would again stress that the comparison we have made on the basis of a group of companies taken at random does not mean that we claim that they are representative of British industry as a whole. We certainly would not, on the basis of such a limited number of firms, presume to draw conclusions as general as those set out in para. 34 of the F.B.I.'s pamphlet. To a general treatment of the main issue raised by the F.B.I. we now turn.

Part II—Provision for Depreciation by Enterprises in 1938 and 1950

35. It is generally accepted that, taking industry as a whole, the amount of investment since the war has been limited not by the lack of financial resources but by the shortage of raw materials and manpower. Even so a larger proportion of the national income has been devoted to investment during the last three years for which figures are available than in 1938, as the figures in Table 1 show.

TABLE 1

	1938	1946	1947	1948	1949	1950
1. National Income (£ m.)	5,253	9,021	9,661	10,632	11,453	11,970
2. Gross Capital Formation out of Income (£ m.)	775	891	1,290	2,090	2,327	2,506
2 as percentage of 1	14.7 per cent.	9.9 per cent.	13.4 per cent.	19.6 per cent.	20.3 per cent.	20.9 per cent.

(Cred. 5283, Tables 6 and 29).

Nevertheless it is argued that industry is being starved of capital funds by the high rates of taxation and that the legal depreciation allowances are not sufficient to maintain capital intact. These arguments are not supported by the figures which are available.

36. Table 2 shows that the depreciation charges and additions to free reserves by enterprises have been higher during the post-war years than before the war, and since 1947 markedly higher.

TABLE 2

	£ million					
	1938	1946	1947	1948	1949	1950
Depreciation charges:						
(a) Initial Allowances	—	143	130	121	225	260
(b) Other Allowances	367	460	560	629	705	782
Undistributed Profits	172	301	450	524	657	569
Less provision for stock appreciation	60	-55	-250	-135	-7	-205
Additions to free reserves after provision for stock appreciation	232	246	200	389	490	364

(Cred. 5203, Tables 6 and 29).

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[Continued]

Calculations which have already been made* indicate that in 1948 the depreciation provision by enterprises made adequate allowance for the rise in the prices of capital goods that had taken place between 1938 and 1948. As the Budget of 1949 doubled the initial allowance on new capital it is not clear why the level of depreciation allowances since then should have been below replacement cost. In what follows a similar calculation is carried out for 1950.

Depreciation of enterprises in 1938 and 1950

37. The 1938 and 1950 depreciation figures for enterprises given in Table 29 of Cmd. 8203 will not do as they stand since they include the repairs allowances of non-profit-making bodies granted under Schedule A, and local authorities' provision for repairs to houses and repayment of housing debt.

38. However, the 1938 figure for these items has been estimated at £160 million.* In 1949-50 Schedule A allowances for profit and non-profit-making bodies together were about £10 million higher than in 1938-39. (This small increase must have been due to rent control and the fact that there has been no general revaluation under Schedule A since 1936.) On the other hand local authorities' provision for repairs to houses and repayment of housing debt seems to have been about £20 million higher. These increases suggest a figure of £130 million for 1950. If these estimates are accepted the depreciation figures for profit and non-profit-making bodies (including local authorities' housing provisions) can be shown separately as follows.

TABLE 3

PROVISION FOR DEPRECIATION INCLUDING MAINTENANCE OF BUILDINGS

	£ million	
	1938	1950
Enterprises	267	892
Non-profit-making bodies	100	130
Total	367	1,022

It will be seen from Table 3 that in 1950 the provision for depreciation by enterprises (private and public) was 3.3 times the 1938 figures.

Changes in the stock of capital since 1938

39. An official estimate of the changes in the stock of capital during the period 1938 to 1950 is not available. However, an indirect estimate† suggests that the stock of capital was about the same in 1950 as in 1938. This estimate was obtained by deflating the yearly figures for gross capital formation (taken from the Annual Abstract of Statistics 1938-49 and Cmd. 8203) by capital goods price indices (1938=100) to give figures for gross capital formation at 1938 prices; deducting the 1938 depreciation figures to obtain figures for net capital investment during the years 1938-50; and taking into account the amount of war damage (officially estimated at £860 million in 1938 prices) and the value of that part of war capital investment which has peace-time uses (estimated at £370 million in 1938 prices by E.C.A.).

40. An alternative estimate is provided by Professor E. A. G. Robinson in the London and Cambridge Economic Service Bulletin for May, 1950. He estimated that by the end of 1950 the volume of capital would be about £620 million greater than in 1938 at 1945-46 prices (about £230 million at 1938 prices).

41. Assuming therefore that the stock capital in 1950 was about the same as in 1938 the depreciation per unit of stock increased 3.3 times.

* Oxford University Institute of Statistics Bulletin, July and August, 1949, p. 213.

† See E.C.A. "Facts about the British Economy", February, 1950: Table 15A.

Capital goods price index

42. The next step is to estimate the rise in the price of goods entering into gross capital formation in 1950 compared with 1938. An index can be constructed as follows: * for plant and machinery the export average value indices for machinery and electrical goods are taken from the Board of Trade Journal and combined in proportion to their share in post-war exports; for vehicles the "vehicle" export average value index is used; for stock-building the "Industrial materials and manufactures" wholesale price index; for building the official estimate for 1949 given in the 1950 Working Party Report on the Building Industry is used after allowing for the movement of building materials and wage costs between 1949 and 1950; and for property transfer costs the index for "other services" implied in the National Income White Paper. The separate index numbers are then weighted by the distribution of gross capital formation in 1938. This gives a final index number for 1950 of 244.

Depreciation provision in 1950 compared with 1938

43. The increase of 3.3 times in the depreciation per unit of capital in 1950 over 1938 can thus be compared with an estimated rise of 2.4 times in the prices of all goods entering into gross capital formation over the same period. Assuming, therefore, that the depreciation provision in 1938 was adequate (there were few complaints at the time) then the depreciation provision in 1950 was ample. In any case the increase in the depreciation provision was more than sufficient to absorb the increase in the cost of capital goods between 1938 and 1950.

44. It should be emphasised that all that has been shown is that depreciation allowances in the aggregate were sufficient in 1950. Whether the allowances given to any particular firm were adequate is another matter.

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APPENDIX

COMPARATIVE SUMMARY OF BALANCE SHEETS OF 80 COMPANIES

	£'000	
	1938	1949
Fixed Assets		
Land	27	160
Buildings, plant and machinery	15,152	24,900
Total, fixed assets	15,179	25,060
CURRENT ASSETS		
Stocks	11,423	10,728
Debtors	6,804	16,682
Cash and cash assets	5,469	18,777
Total, current assets	24,696	46,187
Less current liabilities	11,411	24,457
Total, net current assets	13,285	41,730
OTHER ASSETS		
Goodwill, patents, etc.	1,277	708
Investments	1,352	1,867
Total, other assets	2,629	2,575
TOTAL, NET ASSETS	31,084	69,345
Share capital	20,247	24,425
Minority interests	63	352
Share premiums	460	3,089
E.P.T. refunds	—	1,779
Reserves created by revaluation	—	655
Other reserves including P.T. balances	7,124	30,077
Borrowed money—		
long-term	1,639	2,390
short-term	144	2
Deferred liabilities	1,384	1,584
Tax reserves	23	5,644
TOTAL NET ASSETS	31,084	69,345

* cf. Bulletin of Oxford University Institute of Statistics, Jan., 1949, p. 170.

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[Continued]

EXAMINATION OF WITNESSES

3781. Chairman: Will you take your paper which consists of comments on the F.B.I. case study? I want to ask you two or three questions to see whether I have followed the course of your criticism. First of all you drew attention to the fact that on an average the 80 companies they have studied appear to be large employers owning large blocks of assets, is that right?—Mr. OGDEN: Yes.

3782. On the other hand the F.B.I. say in their document that the 80 companies included large, medium and small concerns so that criticism would be right on the average but would not destroy their statement that they have included in their 80 a coverage of large, medium and small. Would you accept that?—I think so. I do not know if Mr. Murray would like to comment on it?—Mr. Murray: Certainly small firms have been included in the survey, but they have been, we feel, far out-balanced by the very large firms that have been dealt with.

3783. And that is shown by the average figure to which you draw attention?—Yes, that is so.

3784. You took, on the other hand, what you say was a broadly a random sample covering 80 companies from the Moody Survey and they turn out to be on the average smaller concerns than the average shown by the F.B.I.—That is so.

3785. Then you raise a question whether the index which the F.B.I. case study employed for valuing the 1938 fixed assets was rightly selected?—We do touch upon that. We do not make a great deal out of it. We merely draw attention to it.

3786. I quite follow. It may have had the result of raising the 1938 figures show what they would have been if they had used what you regard as a more appropriate index?—It would have that effect.

3787. When you came to operate upon the fixed assets of your Moody companies, to raise them to 1949 monetary value, you employed the same method as the F.B.I. had employed dealing with their 80 companies?—Yes, Sir. We took it over bodily and applied it.

3788. And that meant making certain assumptions which I think, as you say, are very general assumptions?—They are indeed. We are aware of their shortcomings ourselves but we had no better technique available to us.

3789. Assuming for the moment that those assumptions were reasonably satisfactory as a whole, the effect was to show, in the case of your 80 Moody companies, that there was a small increase in real value of the 1949 fixed assets over the 1938?—Yes, somewhere between 2 and 13 per cent., taking the two separate bases.

3790. Somewhere between 2 and 13 per cent., the 2 per cent. being contrasted, is this right, with the 3½ per cent. reduction which the F.B.I. one method shows?—That is right.

3791. And the 13 per cent. being of the same order as it would have been as the alternative method which the F.B.I. employed?—Yes, the latter of course necessarily so since we took their figure of 13 per cent. expansion and applied it direct.

3792. On the other hand when you came to express the difference between 1938 and 1949 in the case of the current assets of the Moody companies you found that they had increased to the order of 30 per cent.?—Yes.

3793. That you contrast with a change in the case of the F.B.I. companies in respect of current assets of about 10 per cent.?—9½ per cent.

3794. 9½ per cent. increase in 1949 as against 1938 in respect of current assets?—Yes, that is right.

3795. Now I want to ask you a question. In the case of the fixed assets the F.B.I. study starts from the balance sheet figures of 1938?—Yes.

3796. And you have to contrast them, subject to adjustments, with the balance sheet figures of 1949. You have had to do the same in regard to the Moody companies?—

Yes, except that we have not followed through all the steps the F.B.I. themselves have because we have not got the figures.

3797. You have not followed the steps because you had not the material of the year by year additions and deductions?—That is right.

3798. Having regard to the results which the figures show, do you think you can safely make calculations of this kind in regard to the balance sheet figures of fixed assets?—We realise it is extremely dangerous. We realise it has grave shortcomings, but assuming, and we do make this assumption, assuming the F.B.I. firms had been representative in their experience of rising costs and replacing capital equipment, assuming that, we thought there was a case for using this technique and taking it over bodily and applying it to the firms dealt with in our survey. We were, as I say, conscious it was not altogether satisfactory and we would obviously much have preferred to have had the information and have carried out the step by step analysis which the F.B.I. could do, but assuming the F.B.I. firms experience had been fairly representative, then we thought ours was not too far away from possibility.

3799. If you are trying to arrive at conceptions of physical increase or real value, do you think in a case of fixed assets the balance sheet figures give you any reliable pointer?—We can only take the figures as they are published and assume the firms themselves have not written down excessively these balance sheet figures. Of course we believe the 1938 book values probably were pretty well in line so far as actual book value was concerned; whether the 1949 figures have the same degree of accuracy I should not like to say. If there was a shortfall in the 1949 value as shown in the balance sheet, that would mean these firms covered by the F.B.I. survey were understating their real assets and it would make a difference to the picture, but as we have not got the information we do not know.

3800. I quite appreciate the difficulties, but a balance sheet figure of the fixed assets does not set out to be a currently valued figure?—No, but the use the F.B.I. have made of this figure has been to assume there has not been too great a variance between the two. I think that was the purport of their own document and as I say we have followed them in it.

3801. I was following up a possible line of criticism really from your point of view, whether you can arrive at satisfactory comparisons of fixed assets when you start from balance sheet figures?—It certainly is a point, my Lord, and we would not quarrel with that.

3802. I think you have had a chance of looking at the Inland Revenue memorandum* which drew attention to the fact that the income, even when you have adjusted figures for the change in the value of the £ in the different years, has gone up by about 35 per cent. in the years covered by this survey?—Yes.

3803. So has the employment figure by about 33 per cent., and you query whether such a big increase could have been obtained without a considerable addition to the physical volume in the fixed assets?—Yes, and possibly even stocks. We were struck by the very small increase in stocks in the F.B.I. figures but we could not investigate that very well.

3804. One point I have not followed your criticisms on and that is in the heading "Adequacy of capital resources," paragraphs 28 to 34. I follow your comment about the 35 per cent. increase in the turnover, but apart from that what point are you making on the F.B.I.'s submissions in regard to the adequacy of the capital resources? I do not quite follow where your point gets you to.—We make two or three points here, I am not sure which one you have in mind on this section.

3805. What do they all come to?—We say in fact the resources that these firms have accumulated over the years 1938 to 1949 have in fact been adequate for maintaining the structure of their real capital and, indeed, perhaps for an expansion out of their own resources, that is out of the retained profits, whereas the F.B.I. are arguing that

* This case study is not reproduced in these Minutes of Evidence but it will be published in the Minutes of the Seventeenth Day (1st Aug. 1952).

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[Continued]

the retained profits have not been enough and that the firms had to raise additional capital from outside.

3806. Just to stop you for a moment, paragraph 29 says production was one-third higher in 1949 than 1938 even with less capital investment per employee?—Yes.

3807. In the next paragraph you say:

"It is in some ways unsatisfactory to compare 1938 with 1949 since the period includes two separate phases—the running down of capital during the war years and its rebuilding since the war".

I quite follow that. Then you say in paragraph 31:

"As for depreciation provisions, it should be pointed out that even if the F.B.I. are right in claiming that their firms will have put aside \$17½ millions a year for capital replacement in addition to their normal depreciation charges, this will only mean that firms are appropriating about 2 per cent. of the value of their annual turnover to this purpose, about the same figure as in 1938".

But it still means so far as their claim goes, they will still need twice as large a draft on their profits for this purpose as they are making to date?—Yes, and the firms themselves do appear, from what information we have, to be in a position to do that. That is our impression looking at these figures. It seems to us the proportion of turnover taken for this purpose will not have materially changed and they will be able to do that.

3808. It is a material difference, that in 1938 there was a much less heavy annual draft upon their profits for taxation than they are facing today?—Certainly they are paying much higher taxes today.

3809. We are considering the financial resources available and they have a bigger draft to face. Is it now enough to say that you are putting aside as much as you were?—There is a much heavier profit on which to make this draft.

3810. We do not know how much is being made?—Their profits to provide dividends and for ploughing back into the industry are certainly high, higher than in 1938.

3811. On comparative figures for cash, you say that whereas the F.B.I. firms' cash was, after adjusting for rises in prices, 30 per cent. lower, the cash of the firms covered by your survey was 17 per cent. higher? You go on to say:

"In any event too much importance can be attached to this question of liquidity. The degree of liquidity considered desirable in 1938 may be unnecessary in conditions of full employment".

I do not follow the argument behind that statement.—In times of full employment firms may be more willing to sink their capital into fixed or current assets since they feel more secure. They feel less apprehensive of the future than they must do when conditions of unemployment are in being, and therefore, we are suggesting, it is possible that the proportion of capital which they would wish to maintain liquid may well be smaller than it was before the war. What we are really suggesting is that to compare the amount of cash being held by these firms with what they chose to hold in 1938 is probably not very significant anyway.

3812. It is the argument, is it, that in so far as you are successfully maintaining full employment you eliminate an element of business risk, and in so far as you keep liquid funds against business emergency you need less?—Yes, that is the argument.

3813. There is one other question. When you get to table 2 in paragraph 36 you say just below that:

"Calculations which have already been made indicate that in 1948 the depreciation provision by enterprises made adequate allowance for the rise in the prices of capital goods that had taken place between 1938 and 1948".

When you say "Depreciation provision by enterprises", do you mean the actual provision which the companies made in their own accounts or the depreciation provision allowed by the income tax system?—Mr. Jones: The provision allowed by the income tax authorities including the initial allowances.

3814. Chairman: Now I think it would be convenient if any questions on this paper were put to you before any questions are raised on your other paper in regard to capital gains.

3815. Mr. Kaldor: I have just this one question. You mentioned somewhere a figure of depreciation of 3.3 times pre-war. Where did you get that figure?—That is comparing the depreciation provision for enterprises of £238 millions in 1938 with £892 millions in 1950. May I say that since we wrote this paper we are far from as convinced as we were. May I draw attention to one or two points? First of all the initial allowances have been withdrawn although there is an assumption in our paper that the initial allowances are maintained at 40 per cent. Another assumption is that the stock of capital is the same as before the war which is a very difficult sort of calculation and is far from a firm one, then the stock of capital itself will be lower since the war than before the war and this will affect the depreciation provision. I think if we were revising this part of the paper I would stress more the amount of reserves enterprises have accumulated since the war in addition to the depreciation provision to enable them to maintain capital.

3816. Your main point in this whole criticism of the F.B.I. study is that you do not see that there is any evidence for the view that industrial firms since the war have been drained of resources owing to taxation, that there is no evidence that they have not been able to maintain their real capital intact, whether stocks or fixed assets, or that they are more indebted now in relation to capital which they own than they were before the war?—That is true. We think the main difficulties which industry has been facing have been getting the physical resources and not so much lack of finance.

3817. Professor Hicks: Is it right to conclude that your main criticism of the F.B.I. paper is, on the matter of the selection of firms, that the firms they have selected are not a fair sample?—Mr. Murray: That is one of our criticisms, but by no means our only one. We criticise to some extent, or draw your attention to the use of a particular index, but we think the basis of selection does give grounds for substantial criticism. We do not claim the F.B.I.'s figures are wrong in any sense, but we doubt very much whether they can go quite so far in making general statements on the basis of them as they do.

3818. You would not question that it would be fair to deduce from the F.B.I. paper that there is an important collection of large firms which are relatively worse situated from this point of view than the average firms you have got there?—We would not go so far as that. We were not concerned to decide whether or not the figures in themselves produced by the F.B.I. were accurate, but you will be aware that the paper to which the Chairman has referred by the Inland Revenue does come in on that approach and they bring the internal consistency of the F.B.I. figures under very heavy fire. I think we would substantially agree with what the Inland Revenue say, though we should not go quite so far as they do, but we are not concerned with this internal inconsistency.

3819. It is not questioned that for the 80 firms taken by the F.B.I., if one took 20 of the worse situated within the 80 one would find some pretty hard cases?—Yes, and for the firms covered by the F.B.I. survey, these very large firms, if they were in a very sticky position, and if it were shown they were, then that is something that the Commission would have to take into consideration very carefully. We think the Commission will be able to satisfy themselves that there is not this very serious situation. We say the F.B.I. have not shown it so far but if they do we would not say that this does not matter or it is a matter of no consequence.

3820. Mr. Carrington: Your figures and also those of the F.B.I. are taken to the 1949 accounting date?—That is so.

3821. Would you agree that the position of individual firms, at any rate, has in many instances, changed for the worse since then because of the increase in stock prices?—Yes, Sir, that probably would be true. On the other hand we would not accept that without qualifying it by saying we do not know, on the other hand, what happened to the profits of these firms or firms in general, which may well have counterbalanced the greater pressure that has been put upon them by the rise in prices.

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[Continued]

3822. We are all seeking information on this very vexed issue and I was wondering whether you would have in your office the subsequent cards relating to these 80 companies you worked on. You address yourself to the 1949 position really to check up on what the F.B.I. say about 1947?—Yes. It was done to begin with as a matter of scientific interest to see what would happen. We have those subsequent figures.

3823. Would it be asking too much of you to suggest that you bring your records up to 1951 and see what the position is then?—I think we can manage that, yes Sir; if it would be of any assistance to the Commission, we will.

3824. It would be very helpful if those figures of yours could be brought up to include the 1951 results.—Yes, if you so wish we will let you have them as quickly as we be.

3825. Chairman: Just to get clear how much work we want you to do. You would like the appendix with comparable columns for 1951 and also you would like some of the figures that are used in the text also brought up to 1951?

3826. Mr. Cunningham: I would if possible. The figures I am particularly interested in for 1951 are the cash and borrowed money figures in relation to the current assets and the fixed assets.—We will let you have the appendix complete plus all the tables.

3827. You pass what comments you like on it.—We will certainly let you have those figures, all of them.

3828. It would be extremely helpful if you could.—Certainly, we will.

3829. Mr. Greenwood: I was wondering if the Co-operative Wholesale Society publish any figures that would be useful because presumably they have suffered for the same reasons as the 80 companies mentioned by the F.B.I.—Mr. Jones: We could investigate that.

3830. Are there any figures available for the Co-operative Societies' affairs as regards their cash balances? Their stocks must have gone up considerably.—I expect information is available, but I do not know.

3831. Chairman: I think that is all the questions, subject to any figures you give us later, on your F.B.I. case comment. Now let us see if we can get ahead on questions of capital gains and gambling profit. I should like to know this; when you advocate a tax on gambling and similar activities as a source of income (let us put aside the question whether it is morally right to do it or not, that will have to be solved some time), are you thinking of taxing the man who makes a serious activity of placing bets, or taxing anyone who even makes a single transaction in the course of a year because he has made some money out of the transaction?—Mr. Geddes: We think if you are going to tax them at all you have to tax them all though we admit there are administrative difficulties in the way.

3832. Even a person who made, as some people do, one bet on a horse race? He would be adding to his taxable capacity if he made that bet.—If his total income by the end of the year, including that from gambling, was increased it should be taxed.

3833. You would allow him a net amount in regard to it, if he won on one bet and lost on another?—Certainly.

3834. It is the balance you are considering, so you really see him as somebody in business though the business is placing bets?—Yes.

3835. I follow that, but if he makes a net loss on the year on the activity, why is it not then chargeable against the rest of his ordinary income if the gain is part of his ordinary income?—Mr. Murray: There were two or three considerations in mind. One was that when introducing a new type of measure like this it would be extremely difficult and might lead to a great deal of public reaction if you introduced the full level of income tax rates. If one did, certainly there would be objections to this kind of tax and it was our general feeling, subject to what the Inland Revenue themselves had to say, that it would probably be necessary in the early stages to regard this as a special class of taxation and set the rates at a comparatively low level. Of course if you were fixing it at different rates it would not be appropriate to offset against ordinary income losses from gambling activities. Then there is a second point, that is whether the sort of activity which gives rise to a gain in the gambling field

is really the sort of activity which should be encouraged. We feel, though as I say this is secondary, that if there were a possibility of setting off gambling losses against ordinary income you might not only encourage some people to gamble rather heavily, feeling they had a sort of insurance premium waiting for them, but you would open the way to people claiming they had gambling losses when they in fact had not (just as one does at the moment: some people claim they have won this money through gambling) so you would have another sort of loophole or escape clause. You might say "I am going to knock a lot of money off my ordinary rate of tax because I have been gambling heavily this year" either directly or indirectly in this way. These are the two considerations.

3836. I follow that. Passing to the question of capital gain, what troubles me, if I may say so, about your opening paragraph is that I do not quite recognise the existing law as you state it. You say in paragraph 110: "Under the present tax law capital gains or profits arising from transactions which do not form a part of the ordinary business of the person making them are exempted from tax". Supposing that was not quite right but rather that an activity out of which a man obtained a profit was none-the-less a taxable source although it was not his ordinary business, would your approach to the question of capital gains be the same?—Certainly. In fact, I think it would strengthen me. It was our impression this first sentence was correct but if you have some people taxed on what are in effect capital gains, then having conceded that it is a right and proper sort of income to tax, this is only a question of extension rather than introducing something new in itself, if I follow you correctly.

3837. I am not sure that you have. If I read you might your approach to this problem is that it is absurd to limit a man's profit sources to his ordinary business; is that what you have in mind?—No, rather that it is absurd not to tax a man on income which is not derived from his ordinary employment. Where there is income, there shall taxation lie. That is what we are getting at.

3838. The fact that it is not his ordinary source of getting income is irrelevant?—Yes.

3839. Supposing the law today was that he is none-the-less taxable if he has an activity even if quite outside his ordinary business activity, would you then say the case for a capital gains tax was the same?—Yes, I have got your point now. We recognise that subsidiary occupations or money received from them are in fact taxed. What we have rather in mind here is that under the present tax law capital gains or profits are taxed where people have a job in which the income can be regarded as a capital gain, say a stockbroker or a dealer in stocks and shares. The law says if that is your ordinary business you shall pay tax, but if it is not your ordinary business, if you do it as a sideline and your major occupation lies elsewhere you are not to be taxed. I had not seen the distinction you were drawing. I agree that is the construction we want to put upon the sentence.

3840. Supposing it was, or was declared to be the law, from this point of view that any activity a man indulged in with a view to making gains, however remotely connected with his ordinary avocations, was a taxable source, would that meet your general approach to capital gains?—Yes. If any of his activities give rise to income which he can use as income then a tax upon them would meet what we are seeking for.

3841. I asked that question since I think that kind of definition of the law might avoid the case of the house which is sold at a nominal profit and a new house is bought, and the case of the investment which shows a profit because of a change of interest rates, or the single transaction on which a man makes a profit on something he has not acquired with a view to profit. I wondered if you thought all those things should come in because they are in a sense capital gains, or whether it is the carrying on of an activity which produces an income, even if a sideline remote from ordinary activities, that you want to hit?—We think that should come in. It would be, we think, extremely difficult to define what you call an activity. Any form of income is derived from some form of activity, therefore we see no grounds for excluding any income of this nature from a capital gains tax.

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[Continued]

3842. There is one other question on your proposals, that is paragraph 118. If I have followed your proposal for dealing with machinery for initiating the tax, would you not have to achieve a valuation of all property in the country at a certain date in order to work out how much of the value achieved on a gain after that date was due to the year since the tax was introduced?—You would have to achieve a valuation. You would not necessarily have to do it before the tax came into operation or immediately after the tax had begun to operate. The machine would presumably begin to function where something had been sold and then the question would be asked how much was this worth on (whatever date it was), 1st January, 1953, and then you would value it as at 1st January, 1953, so from an administrative point of view this need not mean the employment of a huge army of valuers immediately. It can be done over a space of time.

3843. I follow. You would have to have machinery which would enable you to say definitely for the purpose of the tax the value of a piece of property at a certain date?—You would have to have machinery which would enable you to arrive at an agreed valuation, together with appeals machinery, but you would have to have machinery for doing it.

3844. Mr. Millard Tucker: Just one or two questions about gambling profits. I see at the end of paragraph 109 you would put a minimum limit below which the net gains should be disregarded. Have you any idea what sort of limit you should think of there?—We thought about this, but quite frankly we could not make any positive suggestion. We recognise that the Inland Revenue might look at it from two angles; one from the point of view of administrative convenience, and one possibly from the hardship angle. We do not know the distribution of property or the distribution of gambling gains and we felt this was something upon which we had no useful advice to offer to the Commission.

3845. Would you cover every kind of gambling then?—Yes, Sir, we would.

3846. Private bets?—We would try to, yes.

3847. Even the things one wins at a church fair?—If necessary, I think the onus should be on the taxpayer to show that he was not liable to the tax in a particular year and if he was a bonded such articles at a church fair, which usually are of a very low intrinsic value, he would not make a positive return to the Inland Revenue authorities.

3848. Supposing a man makes a lot on horse racing and this little prize comes on top of it, so that he is above the figure?—I think from the point of view of equity you would have to bring that in.

3849. Would they have to value their prize which they got in kind?—Yes, one would have to recognise that.

3850. A formidable task?—Mr. Geddes: We said we thought there were administrative difficulties.

3851. What about the people who sit and play bridge all the evening?—Mr. Murray: There too, as Mr. Geddes has said, these points did occur to us. If a citizen is honest and has won 30s. playing bridge it would have to go on his return.

3852. When I was in the army in the first world war we used to play a game called "boussy-boussy"; does all that come in?—Everything that can be construed as betting or gambling gains.

3853. Would it include people who play cards coming up in the train in the morning. There would be a lot of evasion of this tax?—We are not sure that there would, provided one had a reasonable limit below which one would not tax, and provided there was, as there should be, a general acceptance that it was right and proper that an individual who made a lot of money from gambling should not get off scotfree as he does at the present time. We feel public opinion would be on the side of a tax like this. It is a minority of people who win during the year, whereas the majority would lose. Provided one has that general support we see no reason to believe evasion on a large scale should be very widespread.

3854. Mr. Kerwick: I should like to ask this, your main interest in capital gains is to do social justice?—Yes, Sir, and to remove what appears to us to be an anomaly in the law by which incomes of a certain type do escape taxation.

3855. In spite of recognising that there are certain administrative difficulties, we have heard of some from Mr. Millard Tucker, would you have this social justice in spite of the fact that the cost of collection may be great and the yield may be small?—Mr. Geddes: We think most of the points put by Mr. Millard Tucker are covered by our main point that there would be certain exemptions. We think most of the administrative difficulties arising out of that sort of gambling transaction would be covered by the exemption limit.

3856. Do you think the administrative cost of collection when you have fixed that limit will be worth the yield you will get?—We think if the limit is fixed sufficiently high in relation to the information available in the light of the final decision it would be worth while collecting it.

3857. Have you done any research into how much this worth-while amount would be?—Mr. Murray: There are other considerations.

3858. On that specific point, have you any idea what you think might be collected from this source?—No. We have seen an estimate, made, I think, by Mrs. Langley of the Institute of Statistics at Oxford, which does not put the yield at a very high level. She estimates £40 millions, but even so, to concentrate exclusively on the yield, though I realise you are conscious it is only one aspect, to concentrate exclusively on that means we are overlooking some equally important aspect.

3859. Such as?—Such as the elimination of some of the speculative activities that I think do tend to accentuate inflationary or deflationary conditions. We think it desirable that that sort of activity should be diminished as it has no positive helpfulness from the point of view of productive industry.

3860. Mr. Greenwood: I was very interested in paragraph 116, because I think you have something there by means of which, if you can tell us more about it, we may be able to make something before any tax goes on. You say:

"Firms are encouraged to put profits to reserve by a rebate of 40 per cent. of the profits tax, but the very fact of strengthening their reserves is bound to be reflected in a higher value of their shares or the possibility of making bonus issues. Shareholders can therefore realise part of their holding at an increased value. . . ."

and so on. That is very comforting. I was wondering if you had the names of any companies we might go on to before possibly any tax is put on?—Mr. Murray: We at the T.U.C. only know those companies whose shares have appreciated in value. We cannot foresee the firms, otherwise we might improve our own finances, but this does in fact occur.

3861. Actually of course this is not very accurate only except over a very very long period. It would be too easy otherwise if you knew shares were going up if a company had put quite a lot of undistributed profits to reserve. It is not as easy as that.—We cannot see that any other result can come from the ploughing back of the profits and the increased efficiency which results from that, we trust!

3862. You do not think that running into a slump, like the textile industry is experiencing, would have a counter effect on all the ploughing back of profits?—We do not deny that for a moment. That might well result in a reduction in the value of the shares if another influence is at work, but, other things being equal, if you plough back money into the firm, the firm's securities as quoted on the Stock Exchange will tend to increase in value.

3863. Mr. Greenwood: That is not my experience, that is all I can say.

3864. Sir Geoffrey Heyworth: There is just one point on this betting I am not clear about. Do I understand it is your idea that the proceeds of successful bets should be taxed, presumably less the cost of all the bets you have made that are unprofitable?—During that year, yes.

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[Continued]

3845. Since the bookmaker stays in business that means a loss to the state because the winnings are less than the money lost?—But the bookmaker is already taxed.

3866. I know, but on private betting the state would be suffering a loss?—Not necessarily, no. We think in fact the average loss is usually smaller than the average win since you do get odds against, therefore the distribution of gains and losses is not necessarily exactly parallel or exactly symmetrical.

3867. If you take it over a period of years, I take it there is no doubt about it that the amount paid out by bookmakers is less than the amount paid in, is not that right?—Yes, but if you have a lower limit in your tax, then the persons who are losing small amounts of money will not be getting it back.

3868. Does that square with your principles of equity, that this thing should be put right by an arbitrary classification of something on the basis of administrative convenience? Surely not. It seems to me to be the result of muddled thought.—We have no objection to taxing gambling gains down to the last penny if practicable and we would hope that as time proceeded and the tax limit became more acceptable to the public, the tax might be lowered, but we are saying in the early stages it might be necessary to adopt these tactics to reconnoitre the field which will be covered more adequately later on.

3869. Do you bring football pools within its ambit too?—Yes.

3870. And you can deduct the accumulated total of your weekly expenses against any win?—Yes, that is right.

3871. Therefore again over a long period the state would only lose?—Not necessarily, no. If you did get down to the unfortunate position where you had complete taxation to the uttermost penny, it may occur; in these circumstances I agree it might occur.

3872. Mr. Crick: Pursuing this interesting question I notice that in respect of capital gains generally, of which gains from betting lotteries and gaming are to be regarded as a special category, you do not propose to charge the standard rate of income tax?—Initially, no, Sir.

3873. You propose to have a special rate for all that type of supplementary income?—Yes.

3874. Is it a flat rate or a progressive rate?—We would prefer of course to see an element of progression inside R. In the early stages it would probably not be very pronounced but we think it would be desirable to have some form of progression even from the beginning. When I say not so pronounced it would not be so steep as the existing rates of income tax. We think it would be impracticable to achieve that at the very beginning but rather than have a plain flat rate we think the principle of progression should be embodied.

3875. You are thinking perhaps in terms, without tying you to a figure at all, of something like 10 per cent. working up to 25 per cent. for the really big ones, that sort of thing?—Yes.

3876. Rather than having 9s. 6d. in the £ subject to the reduced rates and all the rest of it?—Yes.

3877. I wanted to ask you a question which is not economic, but it is important. Do you see no distinction in principle between gains from betting, lotteries and gaming and the great bulk of what we commonly allude to as capital gains?—In principle, no, Sir. These do represent sources of income and therefore as they are similar in kind should be treated similarly by the tax machine.

3878. Would you not agree in regard to betting, gaming and lotteries that somebody's gain is somebody's loss?—Yes.

3879. That is inevitable?—Yes.

3880. Would you not also agree that one can have a very large volume of widely distributed capital gains which are nobody's loss?—Yes, in so far as the general level of industrial activity is increasing I recognise gains will be made from that which do not represent losses as such to other individuals.

3881. Does not that suggest to your mind that perhaps it is a little illogical to put the two together?—No. We think not, for the reasons I have already given. Here is an individual who admittedly has taken a risk in a football

pool, an industrial share or in buying a motor car and he has got a return on his money which he can use as income. That is just as much income as income from investing in an ordinary share and drawing the dividend from it.

3882. I should like to pursue it because I think it has important implications. I suggest that if I "invest" £100 in a Derby sweep, the nature of the income I hope to achieve from that in the form of a betting gain is not the same as the return I would be expecting to receive if I invested that money in ordinary shares on the Stock Exchange?—It is income just the same. The way in which you choose to spend the money, is what you should direct your attention to, rather than the nature of the income.

3883. Would you not agree that we might be justified in directing our attention to the national implications; the difference being, I suggest for your consideration (I just want your comment on this) that my participation in the Derby sweep has not fulfilled any national economic function whereas my participation in the equity capital of a growing business may very well have performed an economic function. Is there any substance in that?—I agree the distinction is correct.

3884. Does not that either suggest to your mind that there might be some ground for discriminating between these two groups of gains?—I would find it extremely difficult. As you describe it in black and white we can see it clearly, but there is so much shading off into grey in business activity. We do recognise the correctness of what you say by suggesting there should be two levels of tax, two layers of tax, one on short term gains, one on long term gains. The investor who has contributed to productive industry should be taxed in terms of a long term gain if he has got any; the gambler on a short term gain is liable at a higher level. We think there is recognition there in so far as the person is a bona fide investor and not a speculator.

3885. If you advocate both these sources of gain as a proper subject for taxation, then supposing for some reason or other, administrative, social, moral or for some other reason, it was decided that one or other could not be adopted, would you still advocate adoption of the other? That is to say, would you advocate taxation of capital gains if you found the other thing impossible, or if taxation of capital gains should prove impossible, would you still advocate the taxation of betting gains?—The two seem to be independent. Mr. Jones: They do not stand together. I think if it can be shown that one is impossible then we should have to look at it again, but I do not think we should stipulate that unless both gambling gains and capital gains could be taxed, only then could we support the introduction of a tax of that nature.

3886. You would bring as much into the net as you could, that is really the answer?—Yes.

3887. You consider both classes eligible, you would be quite happy if you could get both in, moderately happy if you could get one or other in and your disappointment over one would not deprive you of satisfaction with the other?—Mr. Murray: Our satisfaction would be overshadowed a little, but we should look forward to extending it as time went on.

3888. Mr. Keldor: On gambling profits, would not your point be met if there was a special tax on gambling, one paid with a fairly high exemption, which would make it unnecessary to allow for gambling losses? I find this suggestion of allowing for gambling losses makes any suggestion of taxing gambling was an extremely dubious idea and administratively difficult. Supposing somebody gains an enormous fortune in a football pool or sweepstake, I do not see why he should not pay some tax on that?—It is attractive, I agree, but we felt if there had been expenditure incurred in securing that particular return that should be allowed: on the parallel of industry rather than on the parallel of the individual, I agree.

3889. On capital gains which is rather a more important aspect of your proposals, do you not think that this capital gains tax of the American type which you are advocating here would be very largely ineffective; it is ineffective in America. Do you not think it is the evasion which is responsible for its low yield?—It is a defect

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Mr. C. J. GREGG, C.B.E., Mr. L. MURRAY and Mr. F. JONES

[Continued]

in administration if there is. I do not think we should allow the fact that evasion would be attempted to discourage us from attempting to put the tax into operation. I do not know the extent of evasion and whether it accounts for the comparatively low yield; I would not like to say.

3890. Perhaps I would add that, apart from evasion, it may be avoided by realising on losses and not realising on profits?—True, yes.

3891. When you have tax to pay you sell out the shares that have gone down and not the shares that have gone up?—I should not like to estimate how strong a tendency capital gains would have in affecting or influencing actions of that sort. If one feels the share is going to go down and down and down one would attempt to sell

out in any event, whether one has capital gains elsewhere or not.

3892. In principle you would agree that a tax which taxes gains whether realised or not is better than a tax which taxes net gains, if it were possible to tax people on the net appreciation of their assets in the year?—I would not like to say. Frankly we have not given serious consideration to that. We felt the administrative difficulties were so enormous that in fact we did not think it would be practicable at all. We are open to correction on that. If it can be shown it is practicable we would look at it, but these were the impressions that we got.

Chairman: Thank you very much.

The witnesses withdrew.

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MINUTES OF EVIDENCE
TAKEN BEFORE THE
ROYAL COMMISSION ON
THE TAXATION OF
PROFITS AND INCOME

15

FIFTEENTH DAY

Friday, 18th July, 1952

WITNESSES

Mr. W. H. LAWSON, C.B.E., B.A., F.C.A.	The Institute of Chartered Accountants in England and Wales.	Questions 3893-4069
Sir HAROLD HOWITT, G.B.E., D.S.O., M.C., F.C.A.		
Mr. T. B. ROBSON, M.B.E., M.A., F.C.A.	The General Council of British Shipping	Questions 4070-4215
The Rt. Hon. VISCOUNT RUNCIMAN, O.B.E., A.F.C.		
Mr. A. F. HULL		
Mr. C. W. ASTON		



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1952

FOUR SHILLINGS NET

OP 64

TERMS OF REFERENCE

(As amended 11th March, 1952)

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages; to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer; to consider the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden fairly among the individual members of the community; to make recommendations bearing in mind that in the present financial situation it may be necessary to maintain the revenue from profits and income; and, in so far as they make recommendations which would on balance entail a substantial loss of revenue, to indicate an order of priority in which such recommendations should be taken into consideration."

NOTE

For the guidance of intending witnesses the Commission published a list of the main heads under which evidence was invited. They explained that the list was not necessarily exhaustive and that witnesses could put in evidence on questions not specifically mentioned, provided that they fell within the Commission's terms of reference. The list is reproduced below.

A. General social and economic questions

1. Is the present system of taxation satisfactory, or could it be improved, in relation to:—
 - (a) incentives,
 - (b) risk bearing,
 - (c) encouraging savings,
 - (d) the control of inflationary or deflationary tendencies,
 - (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment,
 - (f) its effect on the distribution of personal incomes,
 - (g) other economic and social objectives?
- These questions can be considered in relation to the taxation of:—
 - (i) salaries and wages (P.A.Y.E.),
 - (ii) profits of businesses and self-employments,
 - (iii) dividends and other sources of income.
2. Would it be advantageous to link Income Tax with social security payments and contributions?
3. Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

B. Particular matters

4. Is the taxation net drawn too widely or too narrowly in relation to:—
 - (a) the taxation of United Kingdom residents (companies or individuals) on overseas profits,
 - (b) the taxation of non-residents on United Kingdom profits,
 - (c) the definition of residence, etc.?
5. (a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particular—
 - (b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?
6. Is the basis of computing income from property under Schedules A and B satisfactory?
7. Should the present rules about deductions for outgoings and expenses be altered?
8. Are the provisions for relief in respect of double taxation satisfactory?
9. Should the present system of graduation by means of the exemption limit, personal allowances, reduced rate relief and Surtax be altered?
10. Should the existing differentiation between earned and unearned income be extended or reduced?
11. Are alterations necessary in the rules governing personal and other allowances?
12. Should the rules about the taxation of husband and wife be altered (a) as regards aggregation; (b) in any other respect?
13. Should P.A.Y.E. be altered or abolished?
14. Should the principle of deduction at source be extended or restricted?
15. Should the method of assessment to Surtax be altered, and in particular should it be deducted from salaries?
16. Are any alterations desirable in the system of administration and the functions of the various statutory bodies or persons connected with taxation?
17. Are any changes in the provisions against avoidance and evasion desirable?
18. Is any alteration necessary in the rules governing the taxation treatment of special classes of taxpayers (e.g., public corporations, co-operative societies, charities)?

THE ROYAL COMMISSION ON THE TAXATION OF PROFITS AND INCOME

FIFTEENTH DAY

Friday, 18th July, 1952

PRESENT:

THE RT. HON. LORD RADCLIFFE, G.B.E. (Chairman)

Mrs. VERA ANSTY, D.Sc.
 Mr. H. L. BULLOCK
 Mr. W. S. CARRINGTON, F.C.A.
 Mr. W. F. CRICK
 Sir HARRY GILL, J.P.
 Professor J. R. HICKS, F.R.S.

Mr. N. KALDOR
 Mr. W. J. KIRSWICK
 Miss L. S. SUTHERLAND, C.B.E.
 Mr. J. MELLARD TUCKER, Q.C.
 Mrs. E. R. BROOKES (Secretary)
 Mr. D. G. DAYMOND (Assistant Secretary)

Mr. W. H. LAWSON, C.B.E., B.A., F.C.A.; Sir HAROLD HOWITT, G.B.E., D.S.O., M.C., F.C.A.; Mr. T. B. RHODES, M.B.E., M.A., F.C.A.; on behalf of the Institute of Chartered Accountants in England and Wales; called and examined.

MEMORANDUM SUBMITTED BY THE COUNCIL OF THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

Part A. General Social and Economic Questions

Terms of Reference

1. This memorandum is submitted in response to the notice issued by the Royal Commission on the Taxation of Profits and Income, appointed under the chairmanship of Lord Justice Cohen with the following terms of reference:

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages; to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer; to consider the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden fairly among the individual members of the community; and to make recommendations consistent with maintaining the same total yield of the existing duties in relation to the national income."

2. In preparing this memorandum information has been sought from regional committees consisting of members of the Institute both in practice and in industry, who may be regarded as representative of members throughout England and Wales although individual members may hold views different from those recorded in this memorandum.

3. The memorandum is arranged under the heads suggested in Part A of the notice issued by the Royal Commission, dealing with what are called "general social and economic questions". The Council does not intend to submit evidence on behalf of the Institute on items (c), (d), (f) and (g) of Head No. 1 as they are largely outside its special field. Several of the matters referred to in this memorandum were dealt with by the Council in its memorandum to the Tucker Committee on Taxation of Trading Profits and where appropriate the submissions made to that committee have been repeated for convenience in this memorandum.

Head No. 1 (a): Is the present system of taxation satisfactory, or could it be improved, in relation to incentives?

4. It is assumed that by "incentives" the Royal Commission means incentives to increase earnings by greater effort and productivity.

(a) Salaries and wages

5. The experience of some members of the Institute appears to indicate that P.A.Y.E. may to a relatively small extent be a contributory cause of absenteeism and of reluctance to work overtime. The primary causes of the difficulties which have been experienced, however, are

probably not so much the P.A.Y.E. method of collection as the high rates of tax, the introduction of income-tax to millions of persons who were outside its scope before the war and the direct relationship of tax payable to current earnings which is particularly emphasised in the case of overtime pay as explained in the next two paragraphs.

6. Income tax is not borne by a person whose total income, less earned income relief (at present one-fifth of the earned income up to £2,000) does not exceed his personal and other allowances. When his income exceeds his allowances and reliefs the excess is taxable at 3s. in the £ on the first £50, at 5s. 6d. in the £ on the next £200 and at 9s. 6d. in the £ on the remainder. The amount of tax payable, when spread over the taxpayer's whole income (including the "tax-free" portion covered by allowances) represents a much lower average rate than the actual rates charged on the taxable portion. The P.A.Y.E. system emphasises the impact of the tax, because the amount deducted from overtime or other additional earnings directly reflects the highest rate of income tax at which the taxpayer is chargeable; thus the amount of tax deducted from additional earnings is a much higher proportion of those earnings than the proportion of tax on normal earnings. In the case of taxpayers chargeable at only the 3s. and 5s. 6d. rates the disproportion can be most marked. For example, a married man without children pays approximately 3s. 3d. per week on earnings of £7 per week, an average of 1s. 2d. in the £; on overtime pay of £1 he would pay a further 4s. 3d. tax, which is nearly four times his normal average rate and more than half of the total tax payable on his normal £7.

7. The structure of income tax (as undoubtedly intended) is such that the burden becomes proportionally greater as the amount of income increases; under P.A.Y.E. this fact is brought home forcibly to the taxpayer, as illustrated in the preceding paragraph, by relating directly to additional earnings the heavier burden of taxation which they attract. This position is aggravated by the steepness of the steps in the rates of tax (3s., 5s. 6d. and 9s. 6d.) because the disproportion becomes suddenly more marked when additional earnings bring the next rate into operation. There is thus reduced incentive to increase earnings by overtime, piecework, bonuses or otherwise. Suggestions are made from time to time that overtime earnings should be exempt from income tax. Such a proposal would place one particular class of taxpayer at a great advantage compared with other taxpayers, it would be open to abuse and would accordingly be an undesirable means of attempting to deal with the problem.

8. On earned income the standard rate of 9s. 6d., after allowing for earned income relief of one-fifth, becomes an effective rate of 7s. 7 1/2d., but this rate is not applicable to earned income in excess of £2,000 per annum. At this

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D.S.O., M.C., F.C.A. AND MR. T. B. ROMSON, M.B.E., M.A., F.C.A.

[Continued]

point the taxpayer ceases to receive earned income relief so that on earned income in excess of £2,500 the effective rate becomes 9s. 6d. plus sur-tax on a graduated scale commencing with 2s. and there is thus an immediate step in the rate from 7s. 7-2d. to 11s. 6d. or more than 50 per cent. Sur-tax rates increase by progressive steps as total income increases and the incentive to earn more may thus be affected by the diminishing net reward for the extra effort. Incentive would be provided by removing or at least raising the limit for earned income relief, by permitting the deduction of earned income relief for sur-tax purposes, or by reducing the rates of sur-tax on earned income.

9. If it is considered desirable that a person should be encouraged to continue working after retirement age, steps should be taken to remove the disincentive effect of the present method of calculating the "age relief" in cases of marginal income. The age relief applies where the taxpayer or his wife is aged 65 or over and it consists of an allowance of one-fifth of unearned income, thus placing the unearned income on the same footing as earned income, provided the total income does not exceed £500 per annum. Where the total income does exceed £500 per annum the tax payable is limited to the sum of (i) the tax which would have been payable if the total income had been exactly £500, (ii) five-eighths of the excess over £500. The effect therefore is that in the income range in which this "marginal" provision operates the effective burden on additional earnings which raise total income beyond £500 may amount to a charge of 12s. 6d. in the £.

10. The matters to which attention is drawn in the foregoing paragraphs indicate that the present system of taxation of salaries and wages is not wholly satisfactory in relation to incentives. The problem whether the system could be improved and the difficulties involved in attempting to do so will receive further consideration in preparing a memorandum on the heads listed under Part B of the notice issued by the Royal Commission.

(ii) Profits of businesses and self-employment

11. The considerations mentioned in paragraphs 3 to 10 above are also applicable to the profits of businesses of self-employed persons and partnerships.

Head No. 1 (b): Is the present system of taxation satisfactory, or could it be improved, in relation to risk-bearing?

12. The fact that the potential net yield after taxation may be too low to justify risking the loss of the capital involved in an undertaking, particularly where the loss cannot qualify for taxation relief, must discourage risk-bearing and therefore result in the curbing of industrial productivity and efficiency and the restricting of enterprise. In addition to the income tax burden the following additional taxes must be considered:

(a) *Profits tax in the case of companies.* As indicated later in this memorandum the whole burden of the profits tax falls on profits which would otherwise be available for reserves necessary to maintain the business and for dividends to ordinary shareholders who bear the major risk. Moreover, the higher rate (which under the proposals in the Finance Bill, 1951, has been changed from 30 per cent. to 50 per cent.) charged on distributions has a serious effect upon the income available for distribution and reduces greatly the attraction of risk-bearing capital. The fact that the profits tax costs and is capable of being increased substantially, in the manner of the recent rise from 30 per cent. to 50 per cent. with retrospective effect, produces uncertainty which must further discourage investors from providing risk-bearing capital. The profits tax has already had the effect of encouraging a considerable scale of the financing of companies by means of borrowed money, because debenture and other loan interest is allowable as a deduction in computing profits for profits tax purposes, whereas dividends on preference share capital are not allowed; on the contrary, the dividends on preference share capital are treated as distributions and therefore result in the company being charged at the full rate on the amount of the preference dividends. The resultant discrimination against risk-bearing capital has made for the development of unound capital structures and the Council

considers that it is undesirable for a separate profits tax to exist. As an indication of this development in capital structures the following statistics are quoted from the "Records and statistics" supplement to *The Economist* of 6th January, 1951:

	Company Issues £ million			
	1947	1948	1949	1950
Debentures	30	11	11	64
Preference	42	23	32	11
Ordinary	115	102	77	59
	187	136	120	134

(b) *Sur-tax.* Self-employed persons and members of partnerships are charged to sur-tax if their total income exceeds £2,000 per annum. Sur-tax is charged on a steeply graduated scale rising at the highest level to 10s. in the £, making with income tax a total charge of 19s. 6d. in the £. There are no means of spreading the sur-tax burden where large fluctuations may occur between the earnings in one year and another and a submission on this matter was made in paragraph 12 of the memorandum submitted by the Council to the Tucker Committee. The Council wishes to support the principle of the recommendation on this matter which is made in paragraph 89 of the report of the Tucker Committee.

13. Another respect in which the existing system of taxation acts as a deterrent in relation to risk-bearing is that no deductions are allowed for certain revenue expenses or for the depreciation or amortisation of considerable classes of capital expenditure. Submissions regarding these matters were made in the memorandum submitted by the Council to the Tucker Committee, in concluding that memorandum the Council stated that many specific anomalies or inequities arise under the existing statutes or have been created through the application of principles derived from decisions of the courts in specific cases; but the Council had taken the view that these numerous anomalies and inequities could be avoided and much time could be saved for the Inland Revenue, the taxpayers and their advisers, if the law were re-stated on the basis of the principles submitted in the Council's memorandum. The Council therefore wishes to repeat the submissions of principle made to the Tucker Committee, namely, that new legislation should be introduced:

(a) To provide that profits for income tax purposes shall be computed in accordance with accepted accounting principles, the gross revenue being charged with the whole expense incurred in earning revenue and with all other expense or loss incurred for the purposes of the business or arising out of or in connection with the conduct of the business; except that no allowance shall be made for any annual payments from which the taxpayer is authorised to deduct income tax under Rule 19 of the Rules applicable to all schedules;

(b) To provide that the allowance of a particular item of expense shall not depend on whether the recipient will be liable to income tax on the amount received or whether the recipient is resident in the United Kingdom;

(c) To permit, in computing profits, the deduction of annual amounts for the amortisation of all capital expenditure other than that incurred on the acquisition of non-depreciating assets;

(d) To permit the calculation of such annual amounts on accepted accounting principles without regard to any initial allowance which has been granted, except that:

(i) Annual allowances will cease to be deducted in respect of any asset when the annual allowances already granted thereon, plus the initial allowance, amount to the cost of the asset concerned; and

(ii) Initial allowances will continue to be taken into account in determining balancing charges or balancing allowances.

(e) To provide for the earliest possible clearance of the complicated position which has been created by the accumulation of piecemeal legislation (for which purpose bold measures may be necessary without undue details).

* Cmd. 8118.

† New I.T.A., 1952, s. 169.

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[Continued]

(f) To counter the loss of relief in the case of businesses which are subject to Dominion income-tax relief or relief under double-taxation agreements, for which one method would be to give the taxpayer the right to choose the extent to which initial allowances are claimed in any year and to carry forward that part of the allowances which did not give him any benefit.

(g) To provide that no expenditure should be disallowed as being capital unless an amortisation charge is allowed, except where the expenditure is incurred on the acquisition of non-depreciable assets.

(h) To provide that accepted accounting principles should be applied in determining whether or not the expenditure should be allowed as an immediate charge or by means of an annual amortisation charge.

It is on the preservation of productive capacity that the future of British industry and the maintenance of the living standards of the whole community depend.

14. Although profits attract income-tax plus sur-tax in the case of self-employed persons and partnerships, or income-tax plus profits-tax in the case of companies, losses of an undertaking can be deducted only from its future profits, except where claims are available under Section 34,* or Rule 13 of Cases I and II of Schedule D,† Income Tax Act, 1918, whereby a loss may be offset against other income. Moreover, there is a time-limit beyond which losses cannot be carried forward so that if sufficient profits have not been earned at the expiration of the time-limit no further relief for the balance of the loss is available. Submissions on this question of relief for losses were made in paragraphs 75 and 76 of the memorandum submitted by the Council to the Tucker Committee. The Council wishes to support the principle of the recommendations made by the Tucker Committee in paragraphs 79, 81, 82 and 83 of its report.

Head No. 1 (c): Is the present system of taxation satisfactory, or could it be improved, in relation to the balance of payments, including the inflow and outflow to and from this country of capital for investment?

15. In recent years a number of United Kingdom companies operating overseas have transferred their management and control abroad, so as to avoid United Kingdom taxation. The mitigation of double-taxation by the various bi-lateral agreements and by the recently enacted unilateral relief appears insufficient by itself to dissuade United Kingdom companies from taking this step. After obtaining the maximum double-taxation relief available, a company controlled from the United Kingdom cannot pay less than the equivalent of the high United Kingdom rates of tax and sometimes has to pay more. The situation obviously compares unfavourably with the position of a company carrying on business and controlled in an overseas country where the rates of tax are appreciably lower than in the United Kingdom. The present position also operates to remove any incentive to an overseas company carrying on part of its business in the United Kingdom to transfer its management and control to this country.

16. An incidental but important result of the transfer abroad of the control of companies has been to take away from the United Kingdom the benefit of the expenditure by those companies upon salaries, rent and incidentals of their former administrative offices in the United Kingdom and upon equipment and stores for their operating units abroad. Such expenditure, having been made out of profits earned abroad, was a form of export which has now been wholly or partially lost to the United Kingdom. Another important consideration is that the domicile of the headquarters in the United Kingdom tends to maintain a closer link between the United Kingdom and the technical experts and skilled craftsmen of the companies operating abroad and it normally leads to the recruitment of British trained staff and technicians for service overseas. There are at all times many other intangible benefits to the United Kingdom, particularly in times of emergency, from maintaining the ultimate control in the hands of directors in the United Kingdom.

17. One method of meeting this situation would be to provide some further measure of relief from taxation upon the profits of businesses operating abroad but managed and controlled from the United Kingdom. It may be noted that under Canadian tax law companies operating abroad but managed and controlled from Canada are not chargeable with income-tax, but dividends paid by such companies remain chargeable on the shareholders at their appropriate rates of income-tax; in the case of non-resident shareholders the rate is fixed at 15 per cent.

18. The Finance Bill, 1951, contains in clause 32* provisions which, if passed into law, will deal with this matter in an entirely different way, namely by making it an offence, punishable by imprisonment and heavy fines, to enter into transactions which, *inter alia*, result in transferring a company's control abroad without Treasury consent. While this may have the effect of preventing the removal of profits from the scope of United Kingdom taxation, it may also have the effect of discouraging the inflow of capital and profits to the United Kingdom. The Council has serious misgivings regarding the long-term economic effects of these proposals in the Finance Bill which may carry the implication that, so far as the United Kingdom is concerned, its overseas industry is a dying one which will disappear over the course of years and be replaced by young and vigorous enterprises established elsewhere.

19. In paragraphs 13 and 14 of the Council's memorandum to the Tucker Committee attention was drawn to the inequity which arises in certain cases of businesses operating overseas and controlled from the United Kingdom, in that income-tax is chargeable on overseas profits as if they arose in the United Kingdom even though it may be impossible to transfer the profits, or a substantial part thereof, to the United Kingdom. This position may arise because of currency restrictions or because of overseas legislation; for example, in certain countries it is necessary to make statutory reserves, or to set aside profits which may be required to meet compulsory payments to employees leaving the business. The Council submitted that income from overseas sources at present assessable under Schedule D on the income arising should not be charged to United Kingdom income-tax until the income comes within the disposition of the assessee and is legally capable of conversion into sterling. In paragraph 304 of its report the Tucker Committee expressed the view that this matter was not within its terms of reference and should more properly be considered by the Royal Commission.

Head No. 2: Would it be advantageous to link income-tax with social security payments and contributions?

20. The question whether payments and contributions under social security legislation should be linked directly with income-tax is one on which there is difference of opinion among the regional committees from which information has been obtained in preparing this memorandum. Such a link would presumably involve the charging of income-tax at an appropriate rate or rates of appropriate rates on all income (without personal, child and other allowances), the abolition of the social security contributions as such and the payment in cash, through the post office or otherwise, of an allowance to every individual, other than those who are receiving unemployment benefit, pensions or similar benefits from State funds. This arrangement would no doubt result in substantial administrative economies for employers, by abolishing the system of stamping insurance cards and possibly simplifying the machinery of tax deductions under P.A.Y.E. Similarly, administrative economies would presumably be experienced in the offices of Inspectors of Taxes by removing from those offices the responsibility for personal allowances and in the national insurance offices by abolishing the system of stamped cards and the necessity for recording contributions.

21. On the other hand the change would require the introduction of considerable administrative machinery and safeguards for the payment of allowances in cash. A further consideration is that there are millions of wage-earners who at present are not liable to income tax because their income is covered by their personal, child and other allowances. In such cases the change would

* New I.T.A. 1952, s. 341.

† New I.T.A. 1952, s. 142.

* New I.T.A. 1952, s. 468.

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result in the necessity for deducting tax from wages and paying the allowances in cash as a separate operation. Moreover, it is important that the cost of benefits which are so personal as those provided under the social security legislation should be brought home to those who pay for those benefits. This is to some extent achieved under the present arrangements, although the contributions cover only part of the benefits. The change would result in the entire cost being hidden in the general income-tax burden and the benefits would tend to be regarded as something to which the individual is entitled without payment, whereas it seems desirable that there should be a far wider appreciation of the fact that the State has no funds other than those which it obtains from the individuals who constitute the State.

22. On balance the Council is not satisfied that it would be advantageous for payments and contributions under social security legislation to be linked directly with income-tax.

23. There is at present one link which the Council considers could with advantage be removed. Social security benefits were originally treated as income for income-tax purposes and the contributions for those benefits were allowed as deductions in computing taxable income. In the case of unemployment, sickness and maternity benefits it was found administratively impracticable to follow that system and in consequence the benefits were relieved of tax and a proportion of the social security contributions was removed from the allowable deductions in computing taxable income. For reasons of simplicity all benefits could well be exempted from income-tax, except in the case of State retirement pensions which are in a rather different category from the other benefits and do not give rise to the same administrative difficulties.

Head No. 3: Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

24. As a 'body of persons' a company was originally regarded as a large partnership and as being assessable to income-tax as agent for its shareholders. It is however now firmly established that the separate corporate existence of a company must be recognised for tax purposes, the company being assessed as a taxpayer on its income, while only the amounts distributed to the shareholders as dividends become their income. The income retained by a company to provide for the maintenance of its productive capacity is not available for distribution to and enjoyment by its shareholders. For this reason it is sometimes argued that the income properly retained by a company should be exempt from taxation. Income-tax, however, is a tax on income whether spent or saved and however desirable it is for profits to be retained and saved in order to maintain productive capacity, it would not be fair to exempt the retained profits of companies from income-tax unless there were also exemption for the corresponding savings of trades and professions carried on by individuals and partnerships. If so radical a change could be contemplated the tax would cease to be a tax on income; it would become a tax on distribution and consumption and would moreover have to be charged at a greatly increased rate in order to maintain the same total yield.

25. The alternative appears to be to introduce appropriate relief from the full burden of taxation on such part of the profits as it is necessary or prudent to retain in the business. On this matter the Council drew the attention of the Tucker Committee to the serious financial difficulties which are encountered by businesses during a prolonged period of high taxation and greatly enhanced prices and the consequent urgent need for relief on profits which are retained in the business for maintaining the physical capacity of the business. The Council pointed out that if it were decided that relief should be given to businesses of all kinds (as distinct from limiting relief to productive industry only) it would be appropriate to introduce a scheme of differential taxation whereby retained profits are given some measure of relief. This would not only provide relief from taxation on the funds required for the re-equipment of fixed assets but would also give relief in respect of the financing of stocks and other current assets. The Council also pointed out

that in the case of companies the introduction of relief in this way would necessarily imply as a first step the removal of the profits-tax, at least in so far as it is charged on retained profits. It is not generally appreciated that the whole burden of the profits-tax falls in effect on retained profits.

26. The present profits-tax imposes on the profits of a corporate body an additional charge of 10s. in the £ and then allows relief of 8s. in the £ in so far as the profits are not 'distributed' within the meaning of the profits-tax legislation. In effect, therefore, the whole of the profits are subject to a charge of 2s. in the £ and a further 8s. in the £ is charged on 'distributions'. Income-tax relief is allowed on the aggregate profits-tax payable. Dividends paid to preference shareholders are not allowed as a deduction in computing the amount on which profits-tax is chargeable and no part of the tax is recovered by deduction from preference dividends. Accordingly the whole burden of the tax falls on the balance of profits which would otherwise be available for reserves necessary to maintain the business and for dividends to ordinary shareholders. If therefore the amount of preference capital is high in relation to ordinary capital, or if the amount of the preference dividend is high in relation to the total profits, the effective combined charge of profits-tax and income-tax on the remaining profits must exceed 10s. 7d. and in extreme cases could exceed 20s. in the £.

27. Because of the considerations mentioned above and those referred to in paragraph 12 (a) in connection with incentives, the Council takes the view that it is undesirable that a separate profits-tax should exist. This matter will receive further consideration in preparing a memorandum on Part II.

28. So long as there is an additional tax on profits however, the profits to be taxed should be computed after allowing for proper remuneration for the directors. In paragraphs 86 and 87 of its memorandum to the Tucker Committee the Council made submissions regarding deductions for directors' remuneration and it is considered that those submissions are preferable to the change proposed in the Finance Bill, 1951. The Council's submissions are therefore repeated below:

(a) The limitation on the deduction allowed for directors' remuneration should be abolished, as view of the income-tax and sur-tax in which the remuneration is subject in the hands of the directors.

(b) If (a) is not accepted, the minimum allowance should be amended so as to take account of the number of directors concerned; and the maximum shareholding permitted for qualification as a whole-time service director should be increased.

29. In paragraphs 88 and 89 of its memorandum to the Tucker Committee the Council submitted, in connection with profits-tax, that where there is 'franked investment income' and other chargeable income, distributions should be deemed to be made first out of franked investment income. This matter was not dealt with by the Tucker Committee in its report.

30. Subject to the important matters referred to in paragraphs (11) to (19) and (24) to (29), the present treatment of companies for taxation purposes is considered to be broadly satisfactory. General, though not detailed, consideration has been given to the fundamentally different systems employed in some other countries such as Australia and the United States but the Council is not satisfied that such a system is preferable to that which has long been used in the United Kingdom, or that there are sufficient disadvantages of the present system to warrant any radical change.

Conclusion to Part A

31. Most of the matters mentioned in this memorandum will, as already indicated, arise again in more detailed form under the other heads listed in Part B of the notice issued by the Royal Commission. It has therefore been assumed that at this stage the Royal Commission requires evidence only on the general principles indicated by Heads Nos. 1, 2 and 3, independently of the specific suggestions to be put forward under Part B.

6th June, 1951.

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EXTRACT FROM SUPPLEMENTARY MEMORANDUM SUBMITTED BY THE COUNCIL OF THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

Head 5 (b)—Capital profits

95. Income-tax is chargeable on "annual profits or gains" but the word "annual" is not used to mean that the profits or gains must recur year after year or even extend over the whole of one year. In general the expression "annual profits or gains", as interpreted by the specific provisions of the Income Tax Acts and by decisions of the courts, means income in its generally understood sense, that is to say profits or gains of the kind considered in the preceding paragraphs under question (c). In the absence of a statutory definition, a capital profit is most conveniently regarded from the negative aspect of being one which does not fall within the meaning of income, and question (b) of this Head will be considered from the point of view of whether the scope of income-tax should be extended beyond income as generally understood.

Capital gains as a source of income

96. A capital gain, as distinct from an accretion in capital value, arises when a capital asset is sold for an amount greater than its cost. By capital asset is meant an asset which is not held for realisation in the ordinary course of business. It is possible that the same asset or type of asset may be a capital asset in the hands of one person and stock-in-trade in the hands of another. For example a motor vehicle is the stock-in-trade of the vehicle manufacturer and the trading profit derived by him from the sale of his vehicles is chargeable to income-tax. On the other hand a trader who buys a motor vehicle for use in his business (for example a newspaper delivery van) has purchased a capital asset and if he should dispose of the vehicle for a sum greater than its cost, the surplus is a capital profit which is not subject to income-tax. Similarly a manufacturing concern which holds investments may realise the investments for an amount greater than their cost and in this case the surplus is a capital profit not subject to income-tax; but where the business itself consists of dealing in investments then the investments are the stock-in-trade of the business and the profits on dealings are income chargeable to income-tax. The criterion is the purpose for which the asset is held. If it is held for realisation in the ordinary course of business, the proceeds of sale are taken into account in computing profits; but if the asset is held for use in the business as a fixed asset and not for realisation, the proceeds in the event of realisation would be a capital receipt.

97. There is thus no certainty that any particular form of transaction will not fall within the scope of the Income Tax Acts. If the owner of a house sells his house for more than he paid for it the surplus is a capital profit which would not fall within the scope of the Income Tax Acts. If, however, the person made a practice, even on a limited scale, of buying and selling houses with a view to profit, it would be open to the Inland Revenue to contend that a trade is being carried on, namely the buying and selling of houses, and that accordingly there is a source of income chargeable under Case I of Schedule D. If the person who had bought and sold houses wished to dispute an assessment raised on such a basis he could appeal to the general or special commissioners but if the commissioners found as a question of fact that a trade was being carried on and if there was evidence to support that finding, an appeal to the courts would be of no avail and the assessment would be maintained. It is always open to the Inland Revenue to proceed in this way, so that any person who seeks to produce an income by means of capital profits may find himself within the scope of the Income Tax Acts on the ground that his income is derived from the carrying on of a trade.

98. The Inland Revenue may be expected to be particularly cautious in attempting to raise an assessment on the basis that transactions which in themselves are of a non-taxable nature are nevertheless carried out in circumstances which amount to the carrying on of a trade. If the nature of the transactions is in any way speculative (which would often be the case) there is a risk of losses

being incurred and such losses would be available to the taxpayer, for set-off or carry-forward in accordance with the provisions of the Income Tax Acts, if the transactions had been treated as being the carrying on of a trade and chargeable under Case I of Schedule D. The view might be taken (although it is doubtful whether it could be maintained in law) that a person who places bets systematically with the object of making an income from that source is carrying on a trade chargeable under Case I of Schedule D; but since such an activity is highly speculative and, over betting transactions as a whole, it is only the bookmaker who makes a profit, it is unlikely that the Inland Revenue would attempt to maintain such a view. The bookmaker himself is of course carrying on a trade and as such is chargeable to income-tax.

99. It will be apparent from what has been stated above that any attempt to produce an income by means of capital gains will normally result in the person concerned being charged to income-tax, except in those cases where the Inland Revenue takes the view that the taxpayer is likely to lose rather than gain by attempting to impose the tax. It remains therefore to consider whether the nature of income-tax should be changed so that it ceases to be a tax only on income but extends also to capital gains as such, even on single transactions.

Taxation of capital gains as such

100. In view of the reply given by the then Chancellor of the Exchequer in the House of Commons on 6th February, 1951, it would appear that the Royal Commission will now have to consider the question of the taxation of capital gains as such. The Chancellor was asked whether he would enlarge the terms of reference of the Royal Commission to include consideration of taxes on capital gains; and he stated in reply that the Royal Commission had been informed that its terms of reference entitle it to consider "The question of charging to income-tax or profits-tax any profit ranking as a capital profit under the existing law which might reasonably be brought within the scope of those taxes".

101. As stated in paragraph 96, a capital gain arises when a capital asset is sold for an amount greater than its cost. In the case of an asset sold by a private individual (for example a house or an investment) the original cost of the asset has not been allowed as a charge for income-tax purposes, the asset will have been bought by him out of savings from taxed income or out of the proceeds of some other asset, or acquired by gift, legacy or similar manner. There is therefore no logical reason why any surplus which arises on disposal of the asset should be chargeable to income-tax unless the principle were adopted of imposing income-tax on all additions to monetary resources—a principle which raises far-reaching and fundamental considerations, as will be seen from later paragraphs. If, however, such a gain were logically charged to income-tax there would be great difficulty in ensuring equity as between taxpayers. The asset may have been held for many years and its original cost may not be capable of verification; or the asset may have been acquired by gift or bequest. A person in need of money would be likely to prefer to borrow on the security of his assets rather than sell an asset which has increased in monetary value over a long period of years, if the monetary gain on sale were chargeable to income-tax; some persons may be able to borrow in this way and escape the tax, whilst others may not.

102. In the case of a business undertaking the position in respect of fixed assets is in one important aspect different from that of a private individual. Amortisation charges in respect of many fixed assets are allowed in computing business profits for income-tax purposes; and if the recommendations made by the Council under Head No. 7 were adopted, amortisation charges would be allowed on all business assets other than those of a non-depreciating nature. Under the system of balancing charges and balancing allowances introduced by the Income Tax Act, 1945, the proceeds of realisation of a fixed

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asset are brought into account, but this is not done for the purpose of charging any capital profit in the event of the asset realising more than its cost. It is done to ensure that over the period in which the asset was held, the aggregate amortisation charges do not exceed the cost of the asset less the proceeds of realisation. A balancing charge is therefore limited by the original cost of the asset; if the proceeds of realisation should exceed the cost, the balancing charge withdraws the amortisation charges already allowed but it does not bring into charge the excess. The Income Tax Act, 1945, has not therefore introduced any departure from the principle that capital profits as such are not within the scope of income-tax.

103. In the case of both private individuals and businesses, any monetary profit which arises on the sale of a fixed asset will, in present circumstances, usually be due in a large measure to the fall in the value of money and to impose a tax on the monetary profit would therefore result in great hardship unless the tax to which the proceeds are put is taken into account. For example, the owner of a house bought in, say, 1938 can undoubtedly make a substantial monetary profit at present-day prices but if the object of selling is to acquire another house elsewhere he will have to buy the new house at present-day prices. If a tax were imposed in such a way that no charge would arise where the proceeds have been applied in the purchase of another asset, there would be grave injustice as between the person who expends the proceeds in this way and the person who does not wish immediately to utilise the monetary proceeds.

104. This question of preserving equity as between one taxpayer and another arises on every aspect of the taxation of capital gains and it leads to some far-reaching and fundamental considerations, for example:

(a) *Unrealised gains.* Two taxpayers may each possess a similar asset acquired at considerably less cost than the present-day monetary value. Through personal circumstances one taxpayer may find it necessary to realise his asset whilst the other taxpayer is able to retain his. The taxpayer who has realised his asset may be in particular need of the proceeds and therefore likely to suffer hardship in the event of the monetary profit being subjected to income-tax; whereas the other taxpayer suffers no tax on the unrealised appreciation in the monetary value of his asset. This must inevitably lead to the question of imposing tax on unrealised gains which in the opinion of the Council would produce an intolerable situation. In the United States where a capital gains tax is in operation, it is an established principle that only realised gains are taxed.

(b) *Gaming profits.* If the principle were adopted of imposing income-tax on the capital profit arising on the sale of an investment which may have been bought deliberately as a speculation, the question arises of whether there is any difference in substance between such a transaction and other speculative activities such as betting, football pools, crossword and other competition prizes. The taxing of a capital profit on realisation of an investment would therefore lead to consideration of this other wide field of possible sources of additions to monetary resources. From the standpoint of the national revenue (as distinct from the question of penalising the successful individual) the Eschequer already takes "at source" its share of ultimate gaming profits in the form of the pool betting tax and taxation of the profits of bookmakers and totalisators, whilst on investment transactions heavy stamp duties are payable irrespective of profit or loss.

105. The taxation position in the United Kingdom must be considered as a whole—income-tax at a high rate, sur-tax rising to a level which is virtually confiscatory in the higher income ranges, purchase tax and other indirect taxes payable on a great range of expenditure, profits-tax on companies, and heavy death duties. All these taxes are assessed and collected under an administrative system which (notwithstanding the importance of the present steps to discover certain kinds of evasion) is probably the most efficient in the world in ensuring maximum collection. The whole system is already necessarily complex and requires skilled personnel for its administration. Apart from any other objections which may be raised against the taxation of capital gains, there is the serious

objection that it would inevitably add considerable further complexities to the taxation system and impose a further administrative burden on the national economy.

106. It is necessary to consider also the psychological effect which the taxation of capital gains is likely to have. There is every reason to suppose that it would discourage the sale of assets and thereby tend to retard business development and to restrict the mobility of the population—in other words, the tendency would be towards standstill conditions instead of conditions in which the resources of the country are likely to be developed. (A useful comparison is already available in the artificial factors which have been introduced into land dealings under the Town and Country Planning Act, 1947. One of the chief deterrents of that Act is that it has discouraged the sale of land for development.) A person in need of money would be more likely to borrow on the security of his assets than to realise them and pay tax on the monetary profit. If it did become necessary for a person to sell an asset, there would inevitably be a tendency to discount the tax by increasing the price, thus making the tax a further contribution to the causes of inflation. Moreover, such a tax would be likely to discourage saving. The fall in the purchasing power of money has already affected adversely the investment of savings in government and other fixed interest stocks; investments in equity capital would lose much of what attraction remains if tax were chargeable on the monetary profit arising on sale. Finally, the strain on the taxpayer's honesty is an important consideration. It is generally recognised that existing taxation has proved too much for some taxpayers. The effect of a tax on capital gains may well be to increase greatly the number of transactions which take place for ready cash or even by barter.

Subsistence

107. *The present distinction between profits liable to charge and others not liable to charge as being capital profits is unsatisfactory; and there should therefore be no extension of the scope of income-tax beyond income as generally understood.*

108. If it were decided, in spite of the fundamental objections, to bring capital gains within the scope of income-tax there are certain important practical considerations which should be borne in mind in considering the manner of imposing the tax:

(a) *Long-term gains.*—It would be necessary to place a smaller burden on long-term gains than on short-term gains, otherwise the taxation of the former would to a large extent be the confiscation of the monetary profit which has accrued over a long period through the fall in the value of money. In the United States the distinction is made by treating as a long-term gain one arising on the sale of an asset which had been held for more than six months and by charging the tax on less than the full amount of the gain. Other methods are adopted in other countries. The Council does not suggest any particular method as being one which would be appropriate in the United Kingdom. Indeed, the Council considers that the need to make the distinction is a clear indication of the anomalous and arbitrary nature of a tax on capital gains.

(b) *Rate of tax.*—The higher the rate of any tax, the more its undesirable features become evident. This would be particularly so in the case of a tax on capital gains. A charge at the standard rate of income-tax would emphasise the unfavourable psychological reactions which may be expected. In the United States the tax on capital gains is at a lower rate than that on income.

(c) *Losses.*—It would be greatly inequitable if capital gains were brought within the scope of income-tax but capital losses were allowed to be set-off only against capital gains instead of against any income on which income-tax is chargeable. This is the position in the United States, except that up to 1,000 dollars can be set-off against income if there are no capital gains available. There is an analogy in the United Kingdom income-tax system in relation to Case VI of Schedule D. This is the "sweeping-up" case under which tax is charged on any annual profits or gains not falling under Cases I to V and not charged under any other Schedule:

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examples are commission for guaranteeing a bank overdraft or for underwriting shares, profits of other business transactions which do not constitute a trade, profits of furnished lettings. Since 1927 it has been possible to offset, against Case VI profits, losses on transactions which if they had resulted in profits would have been charged under Case VI. Prior to 1927 no relief could be obtained for such losses and even now relief can only be obtained against Case VI income. If capital gains were brought within the scope of income-tax, the Council would deprecate the treatment of capital losses on the basis now applicable to Case VI losses; the treatment should follow the submissions under Head No. 19 relating to relief for losses.

Head No. 21: Rising price levels

The problem

315. In times of price stability the ascertainment of profit by deduction of the historical cost of goods sold from the proceeds of sales, enables the goods concerned to be replaced without recourse to the margin between cost and selling price or to additional finance from external sources. Similarly the apportionment of the cost of fixed assets over the years in which they are in effective use, by means of depreciation charges to profit and loss account, provides funds for the replacement of those assets as and when they cease to be useful. In other words the charging to profit and loss account of the cost of goods sold and of fixed assets consumed enables the financial capacity of the business for handling a given physical volume of goods to be maintained in a long period of price stability without utilisation of the profits so ascertained or of new funds from outside the business. Profits retained (less the taxation levied on profits) and new funds from external sources are thus available for financing the development of the business, as distinct from the maintenance of its existing physical capacity.

316. In times of rises in price levels such as have been experienced in recent years, the use of the cost basis of profit ascertainment does not enable either the physical volume of stocks carried, or the fixed assets on which the output of the business depends, to be maintained without utilising profits or new funds. With the high rates of taxation ruling in the United Kingdom the margin of net profits available to meet the effects of rises in price levels is inadequate and great difficulty is met in conserving the physical capacity of businesses without recourse to additional finance from external sources, and the obtaining of such finance may present serious difficulties, particularly in the case of the smaller and growing businesses.

317. The combined effect of the rise in price levels and the oppressive burden of taxation has led a number of business men and their advisers to question the validity of the cost basis of profit ascertainment hitherto generally followed by industrial and commercial undertakings. Various suggestions have been made for changes in the basis of accounting. Some accountants suggest the continuance of the calculation of depreciation charges in respect of fixed assets by reference to historical cost, with an additional charge to profit and loss account in order to take into account the change in the value of money since the date of purchase; others advocate the writing-up of fixed assets (either by reference to price indices or by reference to replacement costs) so that depreciation charges would be based on current values; and various other proposals have been made, all having the same underlying purpose of charging against revenue the consumption of fixed assets at current or replacement values. Similarly, various proposals are made for the same purpose in relation to stock-in-trade.

318. Whatever may be the correct view on this debatable matter, the principle of historical cost must, unless and until some satisfactory alternative is available, continue of necessity to be the basis on which annual accounts are prepared for shareholders. The results shown by accounts prepared on the principle of historical cost, for the information of proprietors, are however not necessarily appropriate for use, without modification, for other purposes. When considering dividend policy, the directors of a company have the right to place to reserve such amounts as they consider to be necessary to maintain the physical capacity of the business; but the ability to retain sufficient profits is seriously restricted by the basis and scale of

United Kingdom taxation. The Exchequer takes the major share of the profits of any business and the view may be taken that it is contrary to the national interests for the Exchequer to draw its full share in cash, regardless of whether that cash is available, leaving the proprietors to provide out of their minority share not only reasonable dividends but also the amounts necessary for the maintenance of the business. Taking a long view, the payment of reasonable dividends on equity capital is essential property to remunerate investors and to attract the further capital which it may be necessary to obtain from time to time.

319. It can therefore be argued that the availability of profit should be a consideration not only in determining the distributions to proprietors but also in determining the payment of United Kingdom taxation; in other words that there should be some form of relief in respect of retained profits. In its memorandum to the Tucker Committee the Council outlined briefly the various suggestions which had been made for giving appropriate relief and these fall into three broad types, namely, taxation relief on retained profits, the adaptation of initial allowances, and fixed asset replacement allowances.

Relief on retained profits

320. The giving of taxation relief on all retained profits would give rise to considerable practical difficulties, particularly in relation to businesses carried on by individuals and partnerships. These difficulties led to the view that it might be necessary to relate the relief to expenditure on fixed assets instead of to retained profits as such in which case the relief would become similar in principle to the other two types mentioned in the memorandum to the Tucker Committee, namely, the adaptation of initial allowances, and fixed asset replacement allowances.

Initial allowances

321. Initial allowances were first introduced by the Income Tax Act, 1945. The initial allowance, as amended by the Finance Act, 1949, is 40 per cent. of the cost of plant and machinery and 10 per cent. of the cost of construction of certain industrial buildings. These allowances are taken into account in calculating future depreciation allowances and the effect is therefore to grant a substantial allowance at the commencement of the life of an asset whilst in subsequent years allowances are far smaller than the depreciation properly chargeable in those years. In total there is no increase in the depreciation allowance as it is still restricted to the cost of the asset, the initial allowance being withdrawn gradually through the reduced depreciation allowances in subsequent years.

322. In the case of businesses which obtain double-taxation relief the initial allowances give rise to anomalies in the calculation of relief and these anomalies are sometimes a serious disadvantage to the business concerned. Another feature of the existing law relating to initial allowances is that the deduction is allowed not in the year in which the capital expenditure is incurred but in the year of assessment based on the accounting year in which the expenditure was incurred.

323. The Council's memorandum to the Tucker Committee included the following observations in regard to initial allowances:

"During the period of re-equipment and expansion which immediately followed the war, the total temporary reduction of tax by reason of initial allowances must have represented a very substantial temporary saving to industry and has undoubtedly been of considerable financial assistance. The percentage rates of the initial allowances are, however, subject to variation from year to year according to government policy and there is no certainty that they will be continued indefinitely on a material scale."

324. The Tucker Committee, for reasons explained in its report, took the view that initial allowances were a satisfactory method of giving relief but almost simultaneously with the publication of the report of the Tucker Committee the then Chancellor of the Exchequer announced the cessation of initial allowances as from 6th April, 1952. The Council would not urge the reintroduction of initial allowances (unless it is desired as a matter of fiscal policy—as in 1945—to give financial assistance

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for the financing of development and expansion, apart from any question of price level) but if the Royal Commission should decide to recommend the use of retail allowances, following the recommendations of the Tucker Committee, the Council would not wish to add to what it stated in the memorandum to the Tucker Committee.

Replacement allowances by price level adjustment

325. The third type of relief dealt with by the Council in its memorandum to the Tucker Committee consists of the introduction of fixed asset replacement allowances, on a basis similar to that adopted in certain continental countries, notably Belgium and France, where businesses have been encouraged to write-up their fixed assets, the object being to express in terms of frames of uniform purchasing power the cost of fixed assets acquired in different years. Businesses in those countries have been permitted to use the written-up amounts in calculating depreciation for taxation purposes and the effect is therefore that taxation allowances for depreciation of fixed assets are related broadly to their current replacement cost. The proposal for fixed asset replacement allowances in the United Kingdom would be on similar lines but adapted so that profits for taxation purposes would first be ascertained after charging depreciation on historical cost and would then be reduced by a supplemental annual allowance. This supplemental allowance would vary according to changes in price levels and would be conditional upon an equivalent amount of profit being retained in capital reserve until replacement is effected.

326. There are various methods by which such supplemental annual allowances could be calculated. They involve complexities and in all businesses whose records of fixed assets are not fully detailed the difficulties might be considerable. If retention in capital reserve were made a condition, as suggested in the preceding paragraph, the safeguards to ensure retention would present further complications, particularly in the case of individuals and partnerships. Apart from these complexities, price levels of future years cannot be foreseen and it is the price at the time of replacement and the availability of funds at that date which are of material importance.

Summary

327. It will be evident from the foregoing paragraphs that the various suggestions which have been made for giving relief in respect of rising price levels, would involve the need for safeguards against the giving of relief on amounts in excess of what it is necessary to retain in the business. Moreover many suggested methods would involve complexities and considerable work in recording the relief given year by year and in ascertaining the accumulated relief in relation to the expenditure incurred by the business for the purposes for which the relief was given. These practical difficulties are serious and it may be that no wholly satisfactory system for annual relief could be devised. Moreover, the Council recognises that arguments can be put forward on behalf of other classes of taxpayer, such as those having incomes of fixed monetary amount, who also have a financial problem in times of rising price levels.

328. If it were decided to give some measure of relief to businesses in respect of the financial effects of rises in price levels, the method which the Council would favour for doing so would be to give relief on retained profits as such, provided it is possible to devise a satisfactory system. If however the practical difficulties which arise in relation to sole traders and partnerships were considered to be insuperable, an alternative arrangement would be:

(a) In the case of corporate bodies, to give some measure of relief on retained profits;

(b) In the case of sole traders and partnerships, to raise the level of income on which earned income relief is granted and either to allow for sur-tax purposes the deduction of the earned income relief allowed for income-tax purposes, or to charge sur-tax on earned income at a lower rate than that charged on unearned income. (This follows the submissions made in paragraph 177 of *Mem No. 9*, independently of the question of rising price levels in relation to business profits.)

329. If the Royal Commission is not able to recommend either relief on retained profits as such, or the alternative arrangement suggested in the preceding paragraph, the Council wishes to put forward a new proposal (dealt with in paragraphs 331 to 335 below) for replacement

allowances in respect of fixed assets; but the Council is not able to make any specific proposal for general relief in respect of profits retained to finance stock-in-trade at increasing price levels, as practical difficulties would arise in attempting to legislate generally for such relief.

330. The taxation legislation does not contain any special rules relating to the valuation of stock-in-trade. In its memorandum to the Tucker Committee the Council made the following submissions on this subject:

(a) Owing to the varying circumstances of different businesses, no particular basis of valuation is suitable for all cases and it is therefore not desirable to attempt to frame special income-tax rules for the valuation of trading stocks.

(b) The method of valuation should be that adopted by the business, provided it is applied consistently from period to period and is based on accepted accounting principles.

A taxpayer may however wish to change the basis previously adopted for his business and the Council consider that the Board of Revenue should be empowered to approve applications, either by particular businesses or on behalf of a number of businesses engaged in the same trade, for any appropriate change in the basis of valuation of stock-in-trade. As an indication of the procedure which might be adopted to enable such applications to be made, attention is drawn to paragraph 3 of Part I of the Sixth Schedule to the Finance Act, 1949. [*Now I.T.A., 1952, s. 287.*]

Proposed replacement allowances for fixed assets

331. The new proposal mentioned in paragraph 329 for replacement allowances in respect of fixed assets, is based on one of the methods which it is already permissible to use for income-tax purposes. Some taxpayers do not claim annual depreciation allowances; instead they adopt what is known as the "renewals method". Where this method is followed there are no amortisation allowances; but when renewal takes place the full cost of renewal is allowed and therefore the taxpayer automatically obtains relief in respect of the higher cost of replacement where price levels have risen since the original asset was acquired. (If price levels fall and the cost of renewal is less than the original cost, then only the cost of renewal is allowed.) Similarly on a second renewal any further rise in price level is again effectively allowed. The proposal which the Council now has to make would bring to all taxpayers the advantage which is now obtained by those taxpayers who adopt the renewals method, namely, the advantage of obtaining automatic relief in respect of the higher cost of replacement where price levels have risen, while at the same time giving appropriate annual allowances.

332. The Council's proposal, which is an adoption of the existing renewals method, is as follows:—

(a) When replacement of an asset takes place, to permit as a deduction for taxation purposes, in the year of assessment in which the expenditure is incurred, an amount equivalent to the excess of the replacement cost over the aggregate of the proceeds of realisation of the old asset and the annual allowances already allowed thereon. Where a replacement allowance is made in this way the future annual amortisation charges for taxation purposes would be calculated on the cost of the old asset. Similarly on a subsequent replacement it should be permissible to deduct for taxation purposes a replacement allowance representing the excess of the replacement cost over the aggregate of the proceeds of realisation of the replaced asset and the annual allowances already allowed thereon; and the future annual amortisation charges for taxation purposes would then be calculated on the cost of the original asset and not on the cost of the one which has been replaced.

(b) Where the replacement involves an element of addition or improvement, or the new asset is not of exactly the same kind as the one which has been replaced, the amount of replacement cost for the purpose of (a) above would be a matter for agreement with the Inland Revenue as is now the case where the renewals method is adopted; and it would be essential for the satisfactory working of the relief for the Inland Revenue to take the same broad view on this matter as is now taken in connection with the renewals method and as was eventually taken in connection with obsolescence claims (see, for example, the statement made on

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9th December, 1931, to the Committee of the Association of British Chambers of Commerce by the then Chairman of the Board of Inland Revenue).

(c) In the event of the replacement allowance, calculated as in (c) above, exceeding the chargeable profits for the year of assessment (as may well happen in the case of businesses such as shipping where large expenditure on fixed assets may take place at infrequent intervals) the excess should be allowed as a carry-forward against future profits or, at the option of the taxpayer, wholly or partly against assessments for previous years, repayments being made accordingly.

333. An example is given in the Appendix in order to illustrate the manner in which the proposal in (c) of the preceding paragraph would operate. It is clear from the example that over the life of any particular asset the replacement allowance plus the annual allowances in respect of that asset would not exceed the expenditure incurred in acquiring the asset. The allowances in total would therefore not be greater than those already available by annual amortisation allowances; but the timing and spreading of the allowances would be different from the existing position, as the effect of the proposal is that replacement allowances would be obtained at the times when replacements take place and therefore when the allowances are needed to provide funds. The proposal would require no special safeguards for the Inland Revenue.

334. The example also shows that the proposal in (a) of paragraph 332 has the effect of combining the replacement allowance on the new asset with the balancing charge or allowance on the old asset. This appears to be the simplest method of operation, but it may be that in some circumstances this combination would give rise to practical difficulties which could be overcome by separating the two aspects. Thus in statement No. 1 of the illustration the first replacement allowance is £30. The alternative method would be to give a replacement allowance of £50 (new cost £150 less original cost £100) and make a balancing charge of £20 on the old asset.

335. The Council recognises that the proposal in (a) of paragraph 332 would have the effect of distorting the relationship between profits for taxation purposes and commercially-ascertained profits, as the replacement allowances would not be charged in the accounts and the subsequent annual allowances for taxation purposes would be less than the depreciation charged in the accounts. For taxation purposes therefore the proposal would require some modification of the submission in items (c) and (d) of paragraph 130 of Head No. 7; and for accounting purposes it would be necessary to make an appropriate adjustment or give an appropriate indication in the accounts where the charge for taxation has been affected materially by replacement allowances or by reduced annual allowances.

5th March, 1952.

APPENDIX

Illustration of Proposed Replacement Allowances for Fixed Assets

Statement No. 1

				TAXATION ALLOWANCES					
				Wear and tear		Replacement allowances		Balancing charge or allowance	
				Cost of Asset	Proceeds on Sale	Amount on which allowed	Allowances given	£	£
				£	£	£	£	£	£
Original asset	...	...	...	100		100	90		
*Annual allowances	...	...	...					50	
Proceeds	...	...	...		30			30	
								120	
1st replacement	...	...	...	150				150	
Replacement allowance	...	...	...					30	30
								£150	£150
Future annual allowances on	...	...	...			100			
*Annual allowances	...	...	...				80	80	
Proceeds—Nil	...	...	...			
								80	
2nd replacement	...	...	...	200				200	
Replacement allowance	...	...	...					120	120
								£200	£200
Future annual allowances on	...	...	...			100			
*Annual allowances	...	...	...				70		
Proceeds—no replacement	...	...	...		50		30		
Balancing charge	...	...	...			20			
						£120	£120		B.C. 20
								£150	£20
Total expended	...	...	...	£450					
Less proceeds	...	...	...	80	£50				
Net expended	...	...	...	£370					
						Against which the taxation allowances have been:			
						Annual allowances	£90 + £80 + £70 =		£
						Replacement allowances			240
									390
						Less final balancing charge			20
									£370

* These are assumed figures to represent the aggregate allowances given over the years from acquisition to disposal of each asset.
† These two columns show only the computation. The third column shows the replacement allowances actually made.

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Moreover, it can be demonstrated that the allowances are not only the same in the aggregate as the net expenditure but also that they are in fact all given at the times when they are needed. This is shown in the next statement, all the figures being taken from the foregoing computation.

Statement No. 2

TAXATION ALLOWANCES POSITION AT TIME OF EACH REPLACEMENT

Original asset	£	£
Cost	100	
Proceeds on disposal	30	
	70	
1st replacement		
Cost	150	120
At this point the taxation allowances have been:		
Annual allowances on the original	90	
Replacement allowances	30	120
leaving for future annual allowances		100
2nd replacement		
Cost	200	
No proceeds on sale of replaced asset		200
		300
At this point the taxation allowances have been:		
Annual allowances on first replacement asset	80	
Replacement allowances	120	200
again leaving for future annual allowances		100
Final disposal		
On sale of the second replacement asset without further replacement the position of the taxation allowances is:		
Annual allowances on second replacement asset	30	
	30	
Proceeds of sale	50	
Balancing charge to cover excess allowances	£20	

It can also be demonstrated that allowances given in this manner will enable the funds to be available to meet replacement costs, provided that appropriate transfers are made to capital reserve in the books of the business. This is shown in the next statement, the figures again being taken from the computation in Statement No. 1. Whether the funds will all be available in cash will however depend on the financial management of the business.

Statement No. 3

AVAILABILITY OF FUNDS FOR EACH REPLACEMENT

(Income-tax taken at 10s. for simplicity of calculation)

For 1st replacement	£	£
Accumulated depreciation on the cost of the original asset (tax free)		90
*Transfer to capital reserve from profits	50	
Deduct tax, no allowance being given	25	
		25
Cash proceeds on sale of original asset	30	
Taxation relief on £30 replacement allowance	15	
		45
Available funds		160
Cost of 1st replacement		150
Excess in hand		£10

(This excess is due to the surplus on sale of the original asset. The book surplus is £20, but £10 of this is taken in tax in computing the replacement allowance. In other words, the transfers to capital reserve need have been only £30 instead of £50.)

* Assumed that an accurate forecast had been made of the increase in replacement cost from £100 to £150.

For 2nd replacement	£	£
Accumulated depreciation on cost of the 1st replacement, £150—say	120	
Allowed for taxation	80	80
		40
Deduct tax charged on excess	20	
		20
Deficiency on disposal (£150 cost less £120 depreciation) provided from current profits	30	
Deduct tax	15	
		15
**Transfer to capital reserve from profits	30	
Deduct tax	15	
		15
Taxation relief on £120 replacement allowance		60
		200
Cost of 2nd replacement		200
Final disposal		
After the 2nd replacement there is no further replacement. The position on final disposal is as follows:		
Accumulated depreciation on cost of the 2nd replacement, £200—say	140	
Allowed for taxation	70	70
		70
Deduct tax charged on excess	35	
		35
Sales proceeds		50
Deficiency on disposal (£200 cost less £140 depreciation and £50 proceeds) provided from current profits	10	
Deduct tax	5	
		5
Balancing charge on £20		10
Funds available		£150
This sum represents:	£	£
Original capital		100
Capital reserve		100
Less taxation charges, since it is no longer invested in fixed assets which attract relief	50	
		50
		£150

** Assumed that an accurate forecast had been made of the increase in replacement cost from £150 to £200 = £50 but that the surplus of £20 on disposal of the original asset had been transferred to capital reserve leaving only £30 to be provided out of profits.

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EXAMINATION OF WITNESSES

3898. Chairman: Mr. Lawson, Sir Harold Howitt and Mr. Robson, we are glad to see you here and, if I may say so, we are very grateful to your Institute for their extremely valuable papers, both on the general subject and on the more detailed questions, you have put in to us which we shall give very full attention to. This morning we only intend to ask you to clear up one or two points on part A subjects with one or two questions on broad points which arise on part B, such as replacement cost and capital gains. Really the questions I am going to ask you to answer for me are by way mainly of elucidating in more detail some of the more general statements you have made. I would like some enlargement of what you say in your first memorandum about incentives, Head 1 (a), because rather earlier on in our sittings we have been brought up against this question of disincentive both in the level of tax in general and also in the method by which it is taken both in regard to the P.A.Y.E. system and in regard to the tax on salaries in the higher levels generally. I see you deal with the question of P.A.Y.E. in paragraph 5 where you say:—

"The experience of some members of the Institute appears to indicate that P.A.Y.E. may to a relatively small extent be a contributory cause of absenteeism and of reluctance to work overtime."

I suppose members of your Institute do get brought into touch with this subject fairly frequently, do not they?—*Mr. Lawson:* Particularly our members who are in industry; a large number of our members are engaged wholly in industry.

3894. Have you been able to collect their views, in any ordered sense, as to what their experience has shown?—*Not in the sense of circularising our members, but we have district committees and a general committee and we have obtained their views so it has had a fairly wide circulation.*

3895. What does it come to, from your point of view, as far as your experience goes? You put it in a very tentative way there—I think it really comes to that. I think we feel there is no very great disincentive effect. It is perhaps the exception rather than the rule but in particular perhaps it causes reluctance to work overtime to a certain extent, but we do not put it very strongly.

3896. One is rather generalising about the psychological reactions of a great many people?—*Yes.*

3897. In paragraph 8 you pass on to the question in regard to the higher levels of salary. Have you any experience in regard to that? Again it is a subject your members must be brought into touch with very much?—*I think it is very hard to say whether there is a real disincentive effect on a man who is earning £2,000 a year. He may be working for quite different motives than money as such, but apart from that it does seem very inequitable that very large jumps in the rate of tax at the £2,000 level.*

3898. I quite follow as a proposition in itself there is this very high jump in the rate. There is also the general argument that if you take an increasing amount off in the higher levels it is likely to discourage people from making an effort and taking a higher post. It is always a matter for argument what people's general reactions are.—*Mr. Robson:* Higher executives have frequently said to us, and I think honestly, that though they themselves continue to work hard and want to work hard if they have the opportunity, they attribute that to their own past method of development. They are very much concerned lest the rising generation should take a different view and I have had it said to me by many people that they regard this point as a disincentive to the coming generation, the effect of which is not yet apparent. I think that opinion is honestly held, and that is all I can say.—*Sir Harold Howitt:* I would confirm that. One has to be guided here largely by hearsay. It is not the kind of thing you can take a questionnaire on, but one hears it very frequently among one's own fraternity "Why am I working so hard, what is the good of it. I have been brought up to work from my youth and that is why I go ahead, but I doubt very much whether that will apply to the coming generation" and one hears the younger people talking in those terms also.

3899. There is a third point I wanted you to enlarge upon and again I quite appreciate that it might be a proposition which one may, or may not, accept, not something one can get actual instances of. In paragraph 12 you say:—

"The fact that the potential net yield after taxation may be too low to justify risking the loss of the capital involved in an undertaking, particularly where the loss cannot qualify for taxation relief, must discourage risk-bearing and therefore result in the curbing of industrial productivity and efficiency and the restricting of enterprise."

Do you come across cases where projects, which would at any rate appear to be useful, are abandoned?—*Mr. Lawson:* I think it is much more difficult to raise money for a speculative type of business than it was before the war. I think we have evidence of that.

3900. And by "speculative" you mean something in which success is not assured?—*Where there is a certain amount of risk in a new undertaking, not speculative in the sense of buying and selling on the stock exchange.*

3901. Because it is true no doubt that in general people habituate themselves to a large extent to a tax system even if it is at first sight a very onerous one, do you not think?—*I think they do, it does change habits.*

3902. Do you think this proposition can be backed up by experience of actual cases which your members have come across?—*I should think so.—Mr. Robson:* I think so. We were so told in committee by members who were not willing to quote specific instances but we were told they had experience which confirmed this.

3903. There is another point I want to ask you about on that paragraph and on the figures you give. You say:—

"The resultant discrimination against risk-bearing capital has made for the development of unsecured capital structures and the Council considers that it is undesirable for a separate profits-tax to exist."

I know you deal with the subject of profits tax in more detail later, but you are not in general opposed, I gather, to a system of taxing company profits that distinguishes between the rate upon retained profits and the rate upon distributed profits?—*Mr. Lawson:* We are not in principle against it, but we see quite considerable practical difficulties in putting such a system into operation.

3904. It is a distinguishing element in the profits tax, as opposed to the income tax, as it bears upon company profits that it does make, in a marked way, this distinction?—*Yes.*

3905. But it is not that element which you think is the vice of a profits tax?—*I think it is the vice of a profits tax at the present rate particularly as regards preference shares. It means a company is obliged to raise money, or feels it advisable to raise money, by loans instead of raising it on capital which might in many cases be a sounder thing to do.*

3906. It produces for the company which is raising capital for the future what you call a distortion of the company's finances?—*And another point is that the rate is very much above the current rate of income tax. When we were thinking in terms of a higher rate of tax on distributed profits I think the sort of thing we had in mind was that distributed profits would be charged at the current rate of income tax which is applicable to everybody; retained profits would bear some lower rate. We were not thinking in terms of a 50 per cent addition.*

3907. But in general in dealing with the taxation of companies or industrial or business profits, one appreciates the distinction that may arise between the unincorporated body and the private company, would you be in favour of one tax however formed, as opposed to the three different kinds of tax at present, income tax, the profits tax and the excess profits levy?—*I think we should. We have not dealt with it yet, we have no mandate but in general I think we probably should.*

3908. I am trying to get your views as distinguished members of your profession. It is an additional complication to see these three taxes?—*Very definitely, particularly*

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in that connection this system of non-distribution relief on profits tax is extremely complicated.—*Sir Harold Howitt:* From the accountant's point of view the last point mentioned by Mr. Lawson is important: accountancy is only a means to a particular end, it is not an end in itself, but the principle of profits tax and non-distribution relief makes accounting, as such, extremely difficult. You have always got the potential claim hanging over you. Balance sheets ignore it by and large but there is always the uncertainty as to what one should put aside to meet a future liability even if it only arises on liquidation. It is a very serious influence in having accounts show a true result.

3909. In your experience have claims for non-distribution relief come in yet at all largely? The main danger is where the company liquidates?—*I have not come across many.*

3910. These figures you give us in paragraph 12, quoted from the *Economist*, I think the Stock Exchange give us the same figures in their evidence. I quite see that in 1950 there was a very marked rise in the volume of the capital raised by debentures and a very marked fall in the capital raised by preference shares, but the peculiar features of profits tax from that point of view did not begin to operate for the first time in that year?—*Mr. Lawson:* I think that is the year when it was increased.

3911. What struck me was that in 1948 and 1949 you had a small amount of capital raised by debentures, and large amounts by preference shares but it is only in 1950 you get this sudden very marked increase in the capital raised by debentures?—*I cannot explain that but I think we can say from our own practical experience in dealing with these matters that this profits tax has had the effect that people have raised capital by debentures and loans who would have issued preference shares if it were not for the profits tax. I think we can say that from our experience.—Sir Harold Howitt:* I have not got the figures before me but I think that position was being accentuated further in 1951 and 1952.

3912. The note I have is that it was first operative in January, 1947, at 25 per cent, then in October, 1949, it went up to 30 per cent, and in January, 1951, which of course we should not see reflected here, it went from 30 to 50 per cent. I think those were the movements?—*Mr. Rossion:* The increase in 1949 might well have something to do with the big increase shown in this table. Apart from the figures, I confirm what Mr. Lawson has said; it is our own experience that people are raising money on debentures or loans because of this very large difference in the taxability according to the form of capital being raised.

3913. I follow what you say in paragraph 13, it is a very important proposal. I do not know if you would agree with me, but if one accepted the suggestion that you should say by Act of Parliament that profits for the purpose of Schedule D, let us say, are profits as ascertained by accepted accountancy principles and these are statutory rules to bear upon them, that would mean, would it not, to begin with that very many decided legal cases would no longer be important because they have been decided upon the basis of the rules that have been in the Income Tax Act in the past? Would you agree that would be a consequence? It might be a good or a bad one?—*Mr. Lawson:* I think it might be, one has to agree that.

3914. As I see it there has been perhaps too great a volume of judicial decisions on what are profits for the purpose of Schedule D, but they are elaborations of what it is thought the statutory rules, which have been there for a hundred years now, by and large, require. If you cut loose from that and said there were no statutory rules, we will have the simple provision you have here, you have to start afresh?—*I think one has to agree that is the difficulty. What we are primarily concerned with is that these items which we pass through the accounts as revenue charges quite properly in our opinion should be allowed for tax. There are so many matters of this sort where a prudent business man must write off certain assets where they are not allowed. That is our main point.*

3915. Let us put aside the recommendations of the Tucker Committee for the moment, if I may. Your proposal, if it was accepted in this form and there were

no statutory rules about prohibited deductions, would mean a very big reduction of the tax revenue, would it not, from business profits as computed under the old system? In other words, many more items of charge would come in than would be allowed under the existing system?—*I do not know whether the amounts would necessarily be very great. I am not certain about that. Possibly the largest item one has in mind is commercial buildings. That would be I imagine one of the biggest items.*

3916. There would be a considerable difference in regard to the ascertainment of mining profits too?—*Yes, and leaseholds.*

3917. Yes, indeed. Apart from that, let us suppose that the proposals of the Tucker Committee, which went a long way towards meeting your point of view on this, were accepted, how much more do you think would be involved if we accepted your double proposition here?—*I must confess I have not got the Tucker recommendations sufficiently clearly in mind to be able to answer that.*

3918. I think in general you would agree that it did recommend a considerable advance on the existing statutory rules as to what would be charged against profits?—*I think it went a long way.—Sir Harold Howitt:* I think we had in mind also, taking a broad view, we have struggled over many years to get accounts into line with the tax liability in those accounts. In the old days you will remember tax was based on an average period and that was not very satisfactory. By degrees, particularly in the Companies Act, 1948, steps have been made to try and make the two things more or less in line with each other, the published profits and the tax liability on them. A spinner has been thrown into the works now by initial allowances and profits tax but we would very much regret having to go back on what is the practice today, viz. having the profits in line more or less with the tax liability on them.

3919. Running through your proposals from (a) to (h) in paragraph 13 is the proposition that no expenditure except expenditure on non-depreciating assets should fall at some stage to go through the profit and loss account?—*Mr. Lawson:* Yes.

3920. I am not clear, and I want you to enlighten me. Is it correct to say that that really removes, for the purpose of the ascertainment of profits, the old test that capital expenditure cannot be charged to the profit and loss account, because all expenditure except on non-depreciating assets would at some stage go through the profit and loss account?—*At some stage, and that is so today in the accounts we prepare.*

3921. What happens when you make a profit on what used to be called a capital asset? In other words, when you have passed through your profit and loss account, at any rate part of its initial cost by way of depreciation allowance, and then it is sold at a profit above what its written down value is, does that go back to the profit and loss account as a credit?—*There is a balancing charge today.*

3922. I meant on the theory you are putting forward here, the accountancy theory?—*I think it is treated in different ways but I think it would come back.*

3923. It would be a logical thing?—*It would be a logical thing.*

3924. If you found you had a surplus on realisation it would come back again?—*Yes.*

3925. The general question on which I would like to hear what you say, is, are there sufficiently accepted accounting principles for one to be able to remit the whole subject to them without any statutory rules?—*Mr. Rossion:* I am venturing to speak first. I should have thought the answer to that was yes, subject to one very big question which you said you were going to ask us about later. On that matter there have been in recent years considerable differences of opinion and I think the accepted practice is to deal with matters on an historical cost basis in that respect, nevertheless there are people who do not accept that practice and it may well be a matter you ought to discuss separately.

3926. I am a little puzzled as to how you envisage it working. The taxpayer's claim to the revenue would be "These are my accounts, they have been audited by a firm of established accountants and the various things

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which they have done are within accepted accountancy principles, and therefore you must accept the figure I bring out accordingly". What is the Revenue to do if it has no rules to found upon? Is the onus on it to challenge whatever has been done and say "We do not think this is an accepted accountancy principle, we will go to the Special Commissioners and ultimately to a law court to decide?"—I should have thought yes, but I should also have thought the Inland Revenue with their very great experience would not find a vast amount of difficulty in proceeding on those lines. I do not envisage if that principle were endorsed in legislation that it would be found very difficult to apply in practice.

3927. I am a little anxious that there should not be too much litigation on particular cases because each of these cases would depend on the evidence as to what were accepted accountancy principles marshalled for the purpose. Could there not be any method by which what were accepted accountancy principles could be ascertained and fixed? A board that could be appealed to?—You could have a board of referees or something of that sort.

3928. There is the Board of Referees, whether rightly constituted for this purpose is another matter?—Sir Harold Howitt: Apart from the contentious matters about rising costs, and apart from the contentious matters about what is a proper rate, I suppose the broad underlying accountancy principle here is the principle that costs shall be written off over the life of the asset in question subject to a residual value. That is the broad underlying principle.

3929. I appreciate that, but there must be many other points, are there not, in the course of ascertaining the profits of all the multifarious activities in this country which raise some dispute as to what the appropriate accountancy method for dealing with them is?—While you were putting the question I was trying to think of them. I am not sure that I have any in mind which would not answer to that general principle.

3930. I have not myself. I am only trying to draw upon the experience of you gentlemen because in a sense it is a great simplification, it is a very attractive idea and I should like to see how it would work out?—Mr. Robson: I think we can test it by our experience of boards of directors. I think it would be fair to say that the greatest difficulties that do arise are in respect of such matters as stock valuation. To some extent of course questions of depreciation do arise upon which there are differences of opinion between directors and auditors but those are matters of quantum rather than principle. I think I would rather confirm Sir Harold's view of them. —Sir Harold Howitt: There is the further point which I am sure is in your mind, which the Companies Act merely emphasises, viz. the point at which a provision becomes a reserve or vice versa.

3931. I follow that. One question on your submission (c) where I did not quite know what you had in mind:—

"To provide for the earliest possible clearance of the complicated position which has been created by the accumulation of piecemeal legislation (for which purpose legal measures may be necessary without undue details)".

I think we should like to know, just for our own assistance, what kind of legislation you are thinking of. The annual introduction of ad hoc provisions in the various Finance Acts since 1947?—Mr. Lawson: I think that is what we had in mind, yes.

3932. On paragraph 15, I am passing to another subject now, there is this very difficult question, which of course we shall have to go into, about the transfer of companies abroad and the methods which are adopted to control possible transfers. What do you think is the main cause which leads companies hitherto controlled, domiciled here, to try to find a domicile abroad? There is more than one possible reason for it under the conditions of the world today?—I should have thought the high rate of tax here is the primary reason. I do not know whether my colleagues would confirm that?—Mr. Robson: I would agree with that.

3933. The high rate of tax here, and one should add to that, the high rate of tax here compared with the rate of tax they will meet where they are going to.—Mr. Lawson: Certainly.

3934. I think I have one or two other questions, before my colleagues ask them, on your second paper, the two subjects in that which we are dealing with today. In head 21 of your second memorandum, you deal with the subject of rising price levels which we have heard a good deal about already in the course of our evidence. I wonder if I could put one question to you which may shorten the thing from my point of view. You have recently issued on behalf of your Institute a document* which you have called "Recommendation XV of Recommendations on Accounting Principles", 30th May, 1952, and it does deal with your present view as it stands today, on accounting in relation to the changes in the purchasing power of money. I read it with great interest. Really it contains all that you wish to say on the subject as a survey on the subject. I know you have special proposals in your evidence?—I think it does. I think we are here to answer questions rather than add to that.

3935. It puts the arguments for the various alternative methods and the arguments against them and does analyse the position as you see it. Would you look for a moment at paragraph 315, again this is a subject we have been brought very much up against. You say:—

"With the high rates of taxation ruling in the United Kingdom the margin of net profits available to meet the effects of rises in price levels is inadequate and great difficulty is met in conserving the physical capacity of businesses without recourse to additional finance from external sources; and the obtaining of such finance may present serious difficulties, particularly in the case of the smaller and growing businesses".

There are two things there, are there not? First of all there is the question to what extent profits are inadequate, without further finance raised from outside, to maintain what you may call the normal level of business activity in periods of rising prices, and you say you have been brought into touch with the actual difficulties experienced by companies, businesses, in that field. Has it been widely spread in your view? Has it fallen more particularly on some industries than on others?—I think it has perhaps fallen more on smaller businesses in some cases. I think they have greater difficulty in raising funds from outside.

3936. I wanted if I could to keep the two things separate, they are a little distinct. First of all there is the difficulty you allude to of businesses maintaining under their own control enough retained profits, all businesses retain some, to keep the existing level of business going with the rise in prices. I wondered if that was an overall view of industry in general or more particularly noticed in some industries than in others?—Mr. Robson: I think it is more noticeable as far as my experience goes in the smaller businesses and in those businesses subject to very severe competition. People who have not got a monopoly position and therefore cannot put up their prices so that even after allowing for tax they have a substantial margin left behind?—Mr. Lawson: I would agree with that. I was trying to think whether it applied to any particular industry, but I cannot.

3937. You could not particularise as between sections of industry?—I find it very difficult.—Sir Harold Howitt: I should think the answer was very largely in line with what Mr. Robson has said. If an industry can put up its prices to such a level to show such a profit that even after taxation it has enough to develop, that particular company can carry on much more easily than the industry which is up against strong competition. It may be as Mr. Robson has suggested that in the monopoly kind of company. I should divide it broadly into those who are able to put up their prices as compared with the others.

3938. Would a very rough division be the export industries on the one side and the more domestic industries on the other?—I should be guessing if I gave an answer to that; I do not really know.

3939. Passing from that, there is this question, which is very hard to get any precise view about, as to the difficulty which such businesses as are in difficulties find in obtaining further finance. May I put this question to you? As a general proposition, if you need a good deal more money to keep your business running than you did

* Not reproduced in these Minutes of Evidence.

[18 July, 1952]

Mr. W. H. LAWSON, C.B.E., B.A., F.C.A., Sir HAROLD HOWITT, G.B.E.,
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(Continued)

before, there is no reason why you should not be expected to raise more capital to find that money?—*Mr. Lawson*: No.

3940. Therefore the question is are there, and on what scale, difficulties in finding that money. I know you have no figures, they are very hard to find, but I would like to draw on the experience of you three gentlemen as to where the pinch comes today?—If I answer that first, I would say it is extremely difficult for a small or medium sized undertaking to raise capital on reasonable conditions, I am speaking of today, in the last six months. That would be my experience.—*Mr. Robson*: I should have thought that prior to the change of government and the change of financial policy the difficulties were nothing like as serious as they have been since the change of financial policy.

3941. If I may concentrate for the moment on the small business to which you refer, is its difficulty due to the fact that the sources of capital which are available to the larger businesses are not open to it, or is it because it has not, in the ordinary way, security of the same kind to offer if it wants to raise money? Why does it fall on the small businesses particularly?—*Mr. Lawson*: Partly because the shares in small businesses are unmarketable and I think, generally speaking, the risks are regarded by an investor, or by a certain class of investor, as being greater in a small undertaking than in a large concern.

3942. That means the public capital market is not open to it?—*Sir Harold Howitt*: I think one must admit that the public capital market does not cater for the small business as it does for the large business. Most of the issuing houses say quite frankly that there is a point at which they are interested and beyond that the concern should go to some other channel for the finance it wants.—*Mr. Robson*: They will say "Bring it back to us in two or three years' time when the profits are twice as much as they are now and we shall be glad to consider it". That kind of attitude is very common.

3943. They want a longer record?—*Mr. Robson*: They want a longer record and establishment of the profits of the business at a higher level before it is attractive to the public.

3944. If they cannot go to the issuing houses what sources are open to them apart from the banks?—*Mr. Lawson*: There is the I.C.F.C., a semi-official body.—*Mr. Robson*: There are two or three small industrial development companies which help small businesses to some extent.—*Sir Harold Howitt*: This matter is in fact being discussed by the issuing houses who realise there is a gap they cannot cater for and they are considering among themselves whether they can set up machinery to be able to cater for these smaller people because they recognise they have not the facilities that bigger people have got. As to where they can go, in answer to your question, I do not know except to the I.C.F.C. and the banks unless they can do it out of their own profits.

3945. And your point is that their own profits are not sufficient?—If they are a competitive business they cannot put their prices up high enough.

3946. It used to be said that there were rich local investors in the industrial centres who could find money in earlier days for the small business which wanted to prove itself. Do they exist today?—*Mr. Robson*: Not nothing like to the same extent as they did 20 years ago.

3947. You would put it as recently as 20 years ago?—And still less, than before the first war.—*Sir Harold Howitt*: One finds it very much from the estate duty angle, businesses wishing for example to raise money in order to clear for estate duty which some of their senior members see ahead. It is very difficult to find an outlet for the small business to raise money in that way.

3948. I have nearly finished my questions but would you turn to paragraph 330 on the question of stock in trade? I only want you to answer this question if you can. Obviously there have been, have there not, in the history of accountancy, quite a few methods used and accepted for valuing stock in trade for the purposes of your accounts? Would you agree that additional methods have already become to some extent accepted in this country?—*Mr. Lawson*: You mean new methods which have started over the last few years?

3949. I cannot give a date, I only want you to give me one if you accept the general proposition.—Subject to what my colleagues say I should have thought not. I think most of the methods now in operation, and there are a number of different methods, started a very long time ago. I am not sure that there have been any recently.—*Mr. Robson*: There are methods used abroad which are not accepted in this country as yet but I do not know myself of any accepted method in this country which has been developed in recent years.—*Sir Harold Howitt*: I should confirm that. Base stock in certain companies, and valuation by relation to sale value with deductions, have run for a long period. The only new method tried out recently is this vexed question of L.I.F.O. which is used in America but has not caught on in this country. Apart from that I cannot think of any major development in this country.

3950. My mind was on some kind of L.I.F.O., but you would say that is not an accepted method in this country today?—*Mr. Lawson*: I should have thought not.—*Mr. Robson*: I do not know of one case in this country.

3951. One more question on paragraph 332 (b); if I follow your proposals what you would like would be to see some relief on retained profits as such, as the tax concession, if one is to be given?—*Mr. Lawson*: If I may say a word there to make our position clear, I think we are not saying positively any relief should necessarily be given. This is a matter for this Commission after hearing the evidence of those who feel the importance of it. What we do say is if the Commission decides relief should be given we would be inclined to favour a differential rate on retained profits, but we have grave doubts as to whether it would be practicable and whether the difficulties would not outweigh the advantages, therefore we have put forward this proposal for replacement allowances as an alternative.

3952. I am much obliged. When you say the difficulties of any scheme which gives relief to retained profits as such, are you thinking of the difficulties which are inherent in the position of partnerships, or are you thinking of the difficulty of finding any scheme which did not put too much discretion, at the expense of the Revenue, in the hands of the controller of the business?—We are thinking of partnerships and private companies mainly.—*Sir Harold Howitt*: We are also thinking of the machinery which is necessary to make sure a vendor does not get away in effect with an untaxed profit.

3953. That roughly means there would have to be, or one would expect to find, some method really for watching what he did with the profits he had retained and that would be a very considerable administrative problem?—Very difficult. It goes further than the actual industry itself; it gets on to the question of an actual sale of shares.

3954. When you speak of your alternative proposal which you put before us as an idea, it raises the difficulty of what is a replacement and how much of what may be generally described as a replacement consists also something by way of addition or improvement. There must have been a good deal of experience by now how these questions are solved?—*Mr. Lawson*: Yes. The renewal basis is still in operation to some extent, therefore there is experience all the time. We felt that the difficulties of our proposal might be less than they are now even under the present renewal system because our proposal is that any item which was not allowed for renewal would attract capital allowances year by year whereas that is not the case with the present renewal system. One would have thought both sides, the Inland Revenue and the taxpayer, would be willing to take a fairly broad view of that subject and so reach agreement.

3955. Your proposal does involve necessarily, does it not, the assumption in regard to all businesses that they can provide a figure of initial cost for all their fixed assets?—It does and that might present difficulty with some businesses. I think the larger companies would have the information but in dealing with a long term change of that sort one must take into account the fact that, in future, records would be kept if this was introduced. There is no difficulty about keeping them.

3956. Are there not some blocks of fixed assets which are given a cost figure or a value figure as a whole and

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Mr. W. H. LAWSON, C.B.E., B.A., F.C.A., Sir HAROLD HOWITT, G.B.E.,
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not an identifiable cost figure for each item, or am I wrong in that?—Mr. Roberts: That certainly happens when a business is bought. A sum might well be paid for the whole of the plant and machinery.—Sir Harold Howitt: I think it does if one buys a liquidated concern. We have seen the criticism of the point you are making by other people. We frankly say there may be difficulty in getting at the information and if the business cannot get it or does not want to keep their books in a way to show it they can stick to their present arrangements.

3957. Chairman: All we are concerned with is a system which, if adopted, might run over a generation. Thank you very much.

3958. Mr. Milford Tucker: Might I ask you to go back for a moment, I am taking the thing in the same order as the Chairman has been taking it, to paragraph 13 of your first paper. When you read that recommendation, is it anything more than this: as the law now stands a taxpayer is directed in the first place to compute his profits in accordance with accepted accountancy principles and then there are a number of rules which may have the effect of eliminating what might otherwise be an item in those accounts. Is not that it?—Mr. Lawson: Yes, I think so.

3959. So the effect of your suggestion is, is it not, to eliminate those subsequent rules leaving just the accepted accountancy principles as the basis of a computation?—Mr. Roberts: Subject to this. I think the original rules themselves did not, as regards the amortisation of fixed assets, assume that they would be treated as an expenditure and depreciation charge in arriving at income. The conception under the Income Tax Acts has been to arrive at profits before charging depreciation and out of the gross of the Revenue you get allowances for wear and tear. We would rather have the concept that profits should be ascertained on commercial principles and not that they should be ascertained on something other than commercial principles and then be the subject of an allowance in computing taxes.

3960. The reason why no depreciation allowance was competent in computing your profits before 1878, before the depreciation rules were introduced, was that, under these special rules, you are not entitled to deduct anything in respect of loss of capital. That is one of the rules, had it not been there you would have had accepted accounting principles whatever they may be.—Thank you. If that is so I need say no more.

3961. It does come to this, does not it? What you say is that the law accepts accounting principles as the main basis of computation but that is complicated by the fact that there are a number of prohibitive rules that follow and upset the proper computation from your point of view?—Yes.

3962. And therefore what you want to do is to eliminate those prohibitive rules and start again. Is not that what you really say in your sub-paragraph (c):—

"To provide that profits for income tax purposes shall be computed in accordance with accepted accounting principles, the gross revenue being charged with the whole expense incurred in earning revenue and with all other expense or loss incurred for the purposes of the business or arising out of or in connection with the conduct of the business, except that no allowance shall be made for any annual payments from which the taxpayer is authorised to deduct income tax under rule 19?"—Yes.

3963. Then if that stood you would not require (c) because that would already be in too?—Agreed.

3964. That is merely by way of emphasis?—That is all.

3965. I move from that, I wanted that clear in my own mind, to your paragraph 15, the beginning of paragraph 15 in your first paper. This is the question of what I call overseas businesses. If you look at paragraph 16, towards the end of it, there is a concluding sentence there which says:—

"There are at all times many other intangible benefits to the United Kingdom, particularly in times of emergency, from maintaining the ultimate control in the hands of directors in the United Kingdom."

Could you for our benefit be a little more explicit about that? I am not quite sure that I understand what you mean by that.—I think those who were drafting this particular paragraph had in mind not revenue or taxation so much as the sort of thing that may happen in a country where the local residents are very nationalistic in their outlook. Where real control is situated in that country then the local business may be operated in a way which is to the detriment of the true interests of the shareholders here, whereas if the directors in this country have real control which they can exercise then that kind of circumstance might be prevented and British trade therefore benefit.

3966. Have you in mind, for example, that if an overseas business requires further capital equipment and it has an English board of directors some preference would be given to this country in supplying that equipment?—There would be a natural drift of trade in that way, but if you had a hostile board of directors, a board of directors hostile to this country, the tendency might be to look elsewhere.

3967. That is the type of thing you had in mind?—Yes.

3968. Now in paragraph 17 you refer to one possible solution and that is the Canadian one in which they charge no tax in respect of a company which is operating wholly abroad as far as its business is concerned. They merely charge the dividends paid by that company whether they are to residents or non-residents of Canada, except that in the case of non-residents there is a special rate of 15 per cent. Would you advocate the same thing here in preference to your present solution? Your present solution is to tax only remittances of profits by that company to this country which is a different solution from that in paragraph 17?—Mr. Lawson: I think we would prefer this proposal of tax being paid only on remittances.

3969. I am just thinking about your solution about remittances. If it is provided that a company which is controlled in this country but is operating entirely abroad, say a foreign railway, is taxed only on remittances, the tendency might be to prevent that company ever sending any money to this country for any purpose.—With all British shareholders remittances would be required for dividends.

3970. Except for paying dividends. Supposing the company wanted to buy a lot of new equipment in this country, it would be doubtful whether the money brought to this country with which to pay for that equipment might be treated as a remittance of profits.—That would not be intended. I should have thought that could be overcome.

3971. If you are in the realm of remittances, it is very difficult to lay down rules as to what remittance is taxable and what is not, is it not? You see one has to remember one would have to adopt in the remittance case some sort of safeguard against manipulation.—Yes.

3972. What view would you take of this situation in such a case: a company has its head office staff here and its directors here, so that it is controlled here, but it is operating entirely abroad and on your solution would only be liable on remittances. That company will remit money to this country to pay its staff their salaries and its directors their fees. Is this company going to be taxed on that amount as a remittance and the directors and staff taxed again on that as their salaries?—I should have thought not.

3973. Are you going to have a sort of separate profit and loss account of the remittances and what they pay out of the remittances? I wondered if you had considered that aspect of it?—I think we shall have to give a little more thought to that. I do not know that I am in a position to answer it at the moment.

3974. It does want a little more thinking out. When you say you suggest the remittance basis, it raises a lot of difficulties at once.—Mr. Roberts: I think people had in mind clearly remittance of profits, but I appreciate there are difficulties in determining whether a remittance is a remittance of profit or something else.

3975. It is almost impossible to tell whether remittances are remittances of profit or not?—Very difficult, yes.

3976. Now, of course, the remittance basis is going to be frightfully difficult if you deal with the case of an

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individual foreign business or a partnership foreign business. I do not suppose there are many individuals with foreign businesses operating entirely abroad?—Mr. Lawson: I should think a very small number.

3977. Is that true of partnerships? Is there an equal scarcity of partnership businesses which are operated abroad but really controlled here in the sense that the dominant partner may be resident here?—There are some, certainly.—Mr. Robson: I should have thought the number was not very great. Their importance in the economy is not very great either.

3978. Do you think you could leave that entirely upon a remittance basis so long as there was some safeguard for manipulations in the form of remittances?—Yes.

3979. You see the House of Lords has recently affirmed the decision in the case of *Hall v. Morley* that you can overcome the difficulty of remitting profits by first borrowing the amount here and subsequently transmitting the debt you owe abroad and having it satisfied abroad. Would you recommend that device in dealing with cases like that?—Mr. Lawson: There are those detailed matters which would have to be considered.

3980. I am pointing these out to you because these matters do arise the moment you begin to think of a remittance basis, do they not? Supposing you had a partnership or individual in such a position, would the remittance basis be satisfied if the man merely borrowed the money out of his own business funds; a partner, for instance, borrowed from his partnership, would you treat that as a remittance of profit?—I do not know.

3981. The next topic I want to ask you about is on the capital gains section, paragraph 95 onwards in your second memorandum. It is, if I may say so, a very clear paper about what I call the normal capital gains, such as speculation, but we have had before us suggestions that profits in the nature of gambling and betting profits should be included. You do not say much about that but do you think that is a practicable proposition?—The profits on gambling?

3982. On any form of gambling or betting.—Mr. Robson: I should have thought it would have added enormously to the administrative side of tax collection. That would be one difficulty. The other would be what should be done on the question of gambling losses.

3983. It would be accepted I think that no gambling loss could be set off except against gambling profits. Eliminate that question and with your practical experience perhaps you could give us your view whether you think such a tax could be workable?—Sir Harold Howitt: I should have thought it would be very difficult to administer that. I do not see certainly how you would keep track of these cases. You would open the door even wider to profits not being disclosed.

3984. Especially as the proposal is that all kinds of gambling, no matter what they are, should come into the picture. It would involve everybody keeping a note-book.—And involve the authorities seeing that he did, which they could not do.

3985. Everybody would have to keep a note-book to jot down all he had made during the year?—Mr. Lawson: A very painful process for some of us.

3986. Your view is, I do not want to question you too closely about it, that it would be unworkable?—Yes.

3987. The last thing I wanted to ask about was a subject in which naturally both I and Mr. Carrington have a considerable interest having already dealt with it once, that is this replacement cost question. I was looking really at your own solution to this problem. That solution does not deal with the question of stocks, does it?—No.

3988. And so far as stocks are concerned I understand your suggestion is that any reasonable recognised basis of dealing with stock should be permitted? Now I want to ask you whether you agree with the proviso to that, once it is adopted it cannot be changed. Is that an accurate statement or not?—Mr. Robson: I think we would say it should not be changed except after some impartial body had been satisfied that it was a proper thing to change it.

3989. Another tribunal?—In paragraph 330 in our evidence we referred to that matter.

3990. You visualize that the taxpayer, if he is on a L.I.F.O. basis and prices dropped, will want to change?—He will want to change but whether the Board of Referees will allow him to do so is another matter.

3991. On what basis would the Board of Referees decide whether he should or should not?—Mr. Lawson: The nature of the business might change quite considerably or the nature of the goods in which he was dealing. One can imagine circumstances in which it would be quite proper if not necessary to change the basis. I think in your opening question you said once adopted it should be permanent but he does want some let-out in some way.

3992. In theory it is very nice to say you refer these matters to a tribunal, but visualize a case in which a taxpayer comes before a tribunal and says "I have hitherto operated on the L.I.F.O. basis, I want to change". There are only two things you can do from that point on, are there not? Either have no rules in the statute as to what are the circumstances and conditions under which he can change and leave it to the Board of Referees, or to have some form of statutory rules within which he has to bring himself if he is to be entitled to change. The first one, leaving it entirely to the discretion of the Board of Referees, do you think that satisfactory?—Mr. Robson: I should have thought so. I have been thinking while you have been speaking about the kind of case that might happen. Supposing L.I.F.O. were permitted for tax purposes in this country, please do not think I am advocating it for one moment, but supposing it was, and supposing market prices dropped, as they did in the middle twenties, the taxpayer would then find L.I.F.O., starting off on the high prices that have been ruling recently, was leading to very unfortunate results from his point of view and he would want to get his tax basis altered. If the position were sufficiently serious I suppose he could wind up his company and start a new one. The Board of Referees might take that kind of factor into account in saying whether they would permit him to make a change and what conditions they would impose in regard to his making a change. I am not envisaging that a taxpayer should be allowed to chop and change his basis of stock valuation as he likes for reasons of matters of ordinary minor convenience but only if some serious change takes place in his position. If he can justify, he should be permitted to change.

3993. It might involve quite a considerable amount of tax even in one particular case, might it not?—Yes, it is a very difficult matter, I realize.

3994. And he will have had some tax benefit in previous years and now he is asking to be let off some tax by the change. Obviously he would not ask to change unless that was so, would he? How would you feel about that? Make him pay a penalty for changing, a money penalty so as to ensure that the Revenue does not really suffer unduly?—Sir Harold Howitt: I think we had in mind as a general rule that if you adopt a policy you stick to it but it may be that is going too far. I do not think we have really considered the power of changing but just thinking aloud I should have thought it could be worded that the onus to prove a case for a change should be on the taxpayer, that he could go to the Board of Referees and ask for a change at any time but the onus of proof is on the taxpayer. Then the question is what rules should you give to the tribunal as a measuring rod.

3995. Have you not yourself sat on a Board of Referees?—Yes.

3996. Would you assume a case comes before you when the man shows it is very disadvantageous to him now, how would you approach the matter as to whether you would give permission to change or not? Have you any idea what principles you would apply in your mind to that?—I left to yourself?—No, I do not think I have. I do not think I have gone into it sufficiently carefully for that, but if one saw that there was real hardship and the alternative was liquidation or some other means which would secure this very end, I think I should be influenced by that point.

3997. What about the taxpayers who have adopted that particular basis of stock and been content to pay what

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would be a higher rate of tax? Is the changeable taxpayer to get the benefit which his fellow taxpayers do not?—If you are putting it to me what I should do if I were on a tribunal, I should want a lot of persuading. You have adopted that principle, you should go on with it, and that is the principle they have adopted in America I think. I should want a lot of shaking.

3998. That is what I thought you would say. I want to be clear about it, it is a very difficult point.—Yes, very difficult.

3999. Just one other point, that is on your solution in regard to the fixed assets. The one thing that strikes me about that, and perhaps you can deal with it is this. All along, both in the Committee on the Taxation of Trading Profits, and up to now in the Royal Commission, one of the main reasons for saying that there should be a change in the method of calculating depreciation allowances is that the companies without it are not able to build up sufficient funds, as the years go on, to replace their assets when the time for replacement comes. Your solution would not meet that difficulty, would it?—Mr. Lawson: I think it would, would it not? What one might call the Inland Revenue share of the funds that had to be built up would be given at the time the expenditure was incurred which would be available at that time and if there were a spreading backwards as we have suggested the taxpayer could obtain full relief at that moment.

4000. But he has not got the money.—He has half the money, he has put aside his own half.

4001. He has half the money?—And knows the other half is coming to him at more or less the same moment in time. That should be good enough.

4002. In what way is that better than the solution proposed of perhaps a larger initial allowance?—Mr. Robson: It is an initial allowance in effect restricted to replacement.

4003. I agree.—That is all it amounts to.

4004. It is a new way of calculating initial allowances.—Sir Harold Howitt: Except that initial allowances are not limited to replacement.

4005. No, I agree.—Mr. Robson: That is the only difference between this method and the initial allowance method. This is restricted to replacement with all the disadvantages we pointed out in that respect to the No. 1 Tucker Committee. It is only in case you deal as a Commission with people replacing old assets as distinct from those buying new assets. We realise it is open to criticism.

4006. It would be almost the same as we have but the old initial allowances law did not limit it to replacement of old assets.—That is the effect of it.

4007. Can I put a question to you? If it is embarrassing do not answer it. Supposing this was not adopted and the other suggestions, much more drastic suggestions of other bodies, are not accepted, would you think the solution or the recommendations of the Tucker Committee for an increased initial allowance, varying with certain businesses if necessary, is a reasonable solution?—Mr. Lawson: I am not sure that we would support the suggestion of variable allowances for different industries.

4008. Leave out variable. A much higher basis of initial allowances, more than 40 per cent. for example, a rate depending upon the prices index.—Would there be a guarantee that it would be maintained? One of the criticisms that we have heard of initial allowances is that these are only interest-free loans, as indeed they are, and the trouble about a loan is that the lender can withdraw it and call in the loan for payment. That is what the Government has done and therefore I think we might be met with the criticism, what guarantee is there that will not happen again when the Chancellor of the Exchequer is hard up and revenue is short? It might be very embarrassing to have a loan recalled. I think that is the type of criticism you will be met with.

4009. Do you say the Government have now done that and called in these interest-free loans?—In effect, over a period of years.

4010. In cases where initial allowances have already been given?—You get a lower rate of wear and tear in the future than you would have done if the initial allowances had not been given.

4011. That was always the case. The Government have not altered anything in that respect, they have only said that no fresh initial allowances will be given.—There are so many businesses which have certain capital expenditure year by year, they are getting each year a new initial allowance.

4012. Mr. Millard Tucker: I see what you mean, thank you very much.

4013. Mr. Kaldor. In this matter of rising price levels, the recommendations of your Institute are, I take it, that accounting should continue to be done on accepted principles of historic cost, but for the purpose of showing in the account the profits, you would recommend that the businesses should create special reserves to cover this difference of replacement cost and also as regards stocks in trade?—Mr. Robson: Reserves out of profits when ascertained.

4014. Not provisions but reserves?—Yes.

4015. That is a growing practice, companies are doing that?—Yes.

4016. Are these reserves calculated on any kind of definite principles? Do these amounts set aside by companies in such reserves correspond to what some people recommend should be done in regard to depreciation allowances? As regards the reserve set aside for stocks, does that correspond to the L.I.F.O. method of ascertaining profits?—I think the answer to that is that people are finding their way in regard to this matter. Some boards of directors make the best guess they can. I do not think you can put it higher than that, and make an appropriation of whatever amount they think suitable. Others use price indices and try to calculate the additional amount which at current price levels it would cost to replace fixed assets and enhance their depreciation allowances accordingly by an appropriation to reserve. In regard to stocks I believe it is true that the accounts of one important company which were issued recently did state that their stock reserve had been calculated on the difference between L.I.F.O. and the ordinary cost or market basis. I do not think there is any general practice. Indeed, our Institute recommends further research should be undertaken and people should experiment with a view to finding as time goes on a suitable method of dealing with this matter. There is no generalisation other than that.—Sir Harold Howitt: The purpose of the final recommendation is, as Mr. Robson has suggested, to ask industry to experiment and to show how they get at the figures they set aside. I am bound to say up-to-date there has not been much specific help in that direction. Round figures have been put aside but the method of calculation has not been disclosed. I think that a because of the difficulty of doing it. If an actual figure has been got out we might be told how it was arrived at. As far as the auditor's certificate is concerned, provided he makes it clear the profit should be calculated before the reserve, he has no further responsibility.

4017. There are one or two points I want to ask you about. In your second memorandum, paragraph 130 you say regarding stocks:

"Owing to the varying circumstances of different businesses, no particular basis of valuation is suitable for all cases and it is therefore not desirable to attempt to frame special income tax rules for the valuation of trading stocks".

But in effect, apart from a few special cases, is it not true to say that the F.I.F.O. method is pretty generally used in this country?—Mr. Lawson: There is quite a substantial variation in the methods of arriving at cost and the methods of arriving at market value.

4018. In other words what you are here referring to are variations of the F.I.F.O. method?—Not entirely. We cover such things as base stock. It is not really an adaptation of F.I.F.O.

4019. It is only in use to a limited extent?—Yes.

4020. From a general economic point of view, I am not sure that I am right in asking you this question, would you say that there was much to be said for a change in this method of stock valuation, for example, from F.I.F.O. to L.I.F.O.?—Mr. Lawson: I am not sure about your opening words "From a general economic point of view". From the point of view of the taxpayer if L.I.F.O. were

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to start to-day it is by no means certain that the taxpayer would benefit.—*Sir Harold Howitt*: I think most people who advocate L.I.F.O. to-day would wish it to be coupled with "or market whichever is lower", which is what they want in America but have not succeeded in getting.

4021. That would be the best of both worlds?—*Yes*.—*Mr. Robson*: You did say from a general economic point of view and if one were to assume for the moment the adoption of L.I.F.O. would diminish very greatly the tax liability on businesses, then I suppose from the general economic point of view one has to say: "Where is the rest of the tax going to be found?" That is the sort of question I am afraid we cannot answer. Obviously if you diminish greatly the tax that is to be found by business, you put the burden on somebody else and what the economic effect of that would be, I do not know.

4022. I suppose, if the Government wished to raise a definite sum in taxation on business profits, then the adoption of L.I.F.O. or the adoption of replacement cost method of calculating depreciation which narrows the basis on which tax is levied would mean a corresponding increase in rates of taxation?—*Presumably*.

4023. Perhaps I could put it in this way, would you say from a general economic point of view there was something to be said for that?—*Sir Harold Howitt*: Altering the basis and putting up the rates?

4024. *Yes*.—Expressing a personal view I would rather stay as we are.

4025. I suppose that is really why your main proposition is that there is a case for reducing the tax on retained profits but that case is not related to any specific thing, rising costs of replacing stocks or fixed assets; in so far as business is not able to obtain sufficient finance to maintain real capital intact, then there is a case for relief in the form of lower rates of taxation. That is your point here?—*Mr. Robson*: We do not go as far as that. We say if you are satisfied there is a case. We do not attempt to say we are satisfied. We say if you are satisfied there is a case then these methods we suggest might be ways of meeting the difficulty. What view you should take having regard to the incidence of taxation on other people is a matter on which we express no view at all.

4026. The heavy taxation on undistributed profits as at present, as you emphasized to the Chairman, is that it chiefly harms the small businesses as against the large businesses; that you say is its chief effect?—*Mr. Lawson*: The higher rate on undistributed profits?

4027. No, the weight of taxation.—The weight of taxation as a whole, that affects everybody and every business but I suppose the burden in a way is heavier on a small business in that it is more difficult for it to raise its capital from outside and to that extent it weighs more heavily on the small business.

4028. There is a certain minimum for exemption from profits tax?—*Yes*.

4029. Would you say that is a conceivable method of giving the relief to small businesses, to raise the exemption limits or to give a kind of minimum initial allowance?—*We have not considered that. We should want to think it out*.—*Sir Harold Howitt*: Will it not raise difficulties of machinery and administration, whether it might not tempt people to split their businesses up into two or three parts, etc.

4030. On this last point I understand now something I did not understand before; in answer to the question by Mr. Millard Tucker you said that the difference between your proposals regarding replacement allowances and initial allowances is simply that the initial allowances when they existed related to all capital expenditure and your proposal is confined to those cases where there is a definite replacement of some existing asset?—*Mr. Lawson*: It comes virtually to that.

4031. Is there in your view some general case from the economic point of view or from the point of view of equity for confining allowances in this way?—*Mr. Robson*: We are expressing no view on that. We merely put it forward as a means, if you should be satisfied that the tax should be so altered, that people who are replacing their assets should have taxation assistance which would

not be available to those expanding their assets. We are conscious that this suggestion is open to criticism from the standpoint of those who feel the expanding business should be assisted. We only put it forward as a means if you follow that policy.

4032. From a machinery point of view, does not your suggestion make the thing more complicated than the initial allowances as they existed after the war?—*Mr. Robson*: Clearly if the allowances are to be restricted to allowances on replacements then very full and careful records will have to be maintained and to that extent administrative complications will arise. If you were to adopt the simple form of an allowance whether it was a replacement or a new asset, then these complications do not arise and to that extent it is simpler.

4033. But your point would be that if the method of initial allowances were adopted as a means of dealing with this problem of rising prices and inflation, then you regard it as essential that it should be maintained and the initial allowances should be varied from year to year?—*Mr. Lawson*: I think one has to qualify what you say. You say as a means of dealing with the question of inflation. Initial allowances apply to capital expenditure and are not dealing strictly with the question of inflation. A new business raising new capital at the time has no problem of inflation. That is a very different point.

4034. I am not sure that I quite agree. A new business has to raise money from somewhere. Wherever it raises its money from, the same difficulties would have to be faced?—*Mr. Robson*: I think the purpose of the initial allowances was not to meet inflation but to assist industrialists to re-equip after the war without necessarily having in mind that they had to pay enhanced prices but merely that they would all need money.

4035. From the economic point of view, as distinct from the point of view of equity, it is only the problem of replacing; that is the only problem is it not, ensuring that capital is maintained and the premises improved as much as possible. In other words, ensuring that the business has adequate capital for outlay on new assets?—*You mean, taking the economy as a whole, that taxes should not come out of money that is required to maintain the industrial equipment of the country*.

4036. Whether money is taxable or not, the problem we have to consider is whether as a result of such taxation the maintenance of real capital suffers, that is the issue. If that is ensured one way or the other by means of monetary policy, financial assistance, initial allowances or in some other way it comes to much the same thing?—*We are getting outside our own special field. I do not know that we can help on that*.

4037. *Professor Hicks*: Am I to understand that your main reason for preferring this system, of what one might call initial allowances confined to replacement, over the initial allowances such as have existed in the past, is that you think allowances so confined might be less liable to be changed about and put up and down as a result of changes in the economic weather than the initial allowances that we have experienced have proved to be? I am still at a loss to know why you prefer your particular type. I was suggesting a possible reason.—*Mr. Lawson*: That is one reason, the one you have given. I am not sure that we do prefer it. What we have tried to deal with in this section of our document is the problem of meeting the replacement of assets at the higher prices consequent on inflation—which is a limited problem—assuming that this Commission were to come to the conclusion that industry has proved its case in requiring assistance for replacement as such. The question of capital assistance for new enterprise and new expansion we have dealt with as a separate matter.

4038. A system which does, in effect, apply to all new capital equipment does, in fact, apply to replacement plus other things. It does in fact cover all replacement?—*If it the appropriate rate, yes*.

4039. Is it not the case that even if you did have a system confined to replacement of the kind you are suggesting, it would not be certain that a Government could properly leave it unaffected by at any rate serious changes in the economic weather? It may be necessary in fact to decide that that is not the moment when you can replace some of your existing assets quite apart from the question

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whether you can make additions to it?—I do not know. I think perhaps this would be a degree safer than initial allowances.

4040. Might I ask one other question on quite a different matter? Going back to your discussion with the Chairman and Mr. Millard Tucker about your paragraph 13, in that discussion we were presented, as I understood, with a picture of an idyllic golden age, 1878, when accountants and the Board of Inland Revenue had the same ideas. Since that time, I am trying to summarise the kind of picture presented to me as an innocent in these matters, we were presented with the picture of the Inland Revenue gradually moving away from their original purity.

4041. Chairman: It is the other way round. Up to 1878 there could be no common ground between the accountant and the income tax system at all because there was no allowance for depreciation at any time. In 1878 they introduced an allowance for depreciation in wear and tear of plant and machinery. That was the first break in the purity.

4042. Professor Hicks: I misunderstood, but after that date, am I not right, the picture presented to us is one in which the accountants and the Inland Revenue were more or less seeing eye to eye, as far as they were seeing perhaps one should say, but after that point there developed this difference of ideas evidently on numerous matters? What I was wanting to ask was why did accounting practice not follow Inland Revenue practice in these matters. What are the substantial reasons for holding that accounting practice is superior to the Inland Revenue practice, which is what I take it must be implied in a suggestion of the kind you are putting forward?—I am wondering whether in the old days you are talking about the Inland Revenue came very much into the thoughts of the accountants at all. Income tax was at a very low rate.—Mr. Robson: On the general question that you pose I think the position would be this, the accountant was trying to use experience accumulated over the years in order to get a fair view of what are the profits of a business and be realistic, for example, that buildings wore out and needed to be replaced. He finds in the tax code, except as regards industrial buildings, and that has only been introduced in recent years, there is no allowance in order to ascertain profits for tax purposes which corresponds to depreciation which any reasonable business man charges in his accounts in ascertaining profits. If a business owns a household property, the life of which is known, at the end of the lease the amount of money which has been spent in acquiring it will have disappeared as an asset from the practical point of view, therefore in ascertaining commercial profits a charge is made for the amortisation of that lease, but there is no allowance of that kind in the tax code. I have only quoted those as examples. There are similar things. Some were dealt with in the Tucker Committee's Report on page 108 at which I am glancing at the moment. It is for that sort of reason I think we, as accountants, feel our methods of arriving at profits are superior to those at present employed by the Inland Revenue. We start broadly on the same basis, but there are some kinds of expenditure, necessary expenditure for the carrying on of business and ascertaining its profits, but these things are not allowed as expenses for tax purposes.

4043. Mr. Carrington: Just taking up that point on which there is some confusion of thought, is it not a fact that in 1878 the taxable conception was really what one would call a cash conception rather than an earnings conception? The question was what was a surplus of business receipts over the payments; that gave you the taxable capacity so you made no allowances under the tax code for any capital expenditure or the writing off of any capital expenditure whatever?—Mr. Lawson: I am afraid I am not well acquainted with that. I do not know what the position was in those days.

4044. There is another example I think of the very narrow view then taken by the Inland Revenue, I think they have learned a little since then, at any rate. You will find in the first volume of Tax Cases a case heard in 1870, which prohibited a deduction for advertising expenses. Now that, I think you would agree, that type of expenditure is now allowed?—Yes, certainly.

4045. And that is allowed on the ground that it is a normal commercial expense unless we are concerned with some capital item like a sign or something of that sort. I am trying to clear Professor Hicks' point. It was not the case that the Inland Revenue in 1878 were extraordinarily virtuous. I think it was that they were extremely ignorant, if I may say so, as to how business was carried on. There was no allowance for any capital expenditure and none for other things which are now allowed. Can I go to the Institute's evidence at paragraph 329 of the second memorandum? You say:—

"The Council is not able to make any specific proposal for general relief in respect of profits retained to finance stock in trade at increasing price levels as practical difficulties would arise in attempting to legislate generally for such relief."

Do you take the view that the American legislation is impracticable for reproduction on our Statute Book?—I do not think we can say it is impracticable. If it has been done in America, I suppose it is practicable to do it here.

4046. You say practical difficulties would arise in attempting to legislate?—Mr. Robson: I think what we had in mind was that, whereas in dealing with fixed assets we were going to suggest later replacement allowances, we could not devise any method of that kind in relation to stock. The L.I.F.O. method you have mentioned is a much wider thing than merely relief in respect of profits retained to finance stock in trade at increasing price levels. It may have other effects when price levels start going down. We do not know much about the practical working of it. We would regard that as a much wider matter, the wholesale change in the basis of stock valuation we would regard as a much wider matter than the specific proposal referred to in paragraph 329.

4047. Can I ask Sir Harold Howitt a question arising out of something he said on this topic? You mentioned that efforts had been made in the United States to alter the law so that the taxpayer had the right to come down to market value in his stock valuation if market fell below his current L.I.F.O. basis. Do I gather from that that the proposal that was put before Congress a month or six weeks ago has been rejected?—Sir Harold Howitt: I would not know that. I was merely speaking from conversations with my American partners who have been over here in a recent Congress. I understood from them that the authorities were resisting the suggestion that in effect the method of valuation should be L.I.F.O. or market whichever is lower.

4048. There has been an amendment lodged with Congress just recently, we have a copy of it as a matter of fact, which would permit, if accepted, the taxpayer to come down to L.I.F.O. I was wondering if you had up-to-date news as to the fate of that amendment?—No.—Mr. Robson: I am aware that an amendment was proposed but I have not seen any news as to what has happened to it. It is very recent, in the last six weeks.

4049. If that were adopted by the United States and a similar thing were introduced here, that would remove the disincentive, shall we say, so far as taxpayers are concerned to going on to the L.I.F.O. basis?—Sir Harold Howitt: Yes. I should think the reason L.I.F.O. has a good hold in America, as it has, is that it has applied over a number of past years and if it came new today it is doubtful how far it would be accepted.

4050. I do not think it would have many backers if it had to start the race today. One point arising out of questions put by Mr. Millard Tucker regarding overseas profits, I think it is the first Document, paragraphs 16 and 17. During the course of the discussion it occurred to me that if the remittance basis was prescribed would it have the effect of inducing companies to leave their reserves overseas rather than bring them home for use of investment here?—Mr. Lawson: It might have that effect, yes.

4051. I speak in ignorance on the subject, but I should like your view, would not that have some influence on the balance of payments?—You might be able to get round that. You might be able to control it in some way just as there is surtax legislation about a private company. It might be possible to provide for something reasonable.

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4052. Something like the 1922 Act requiring companies to bring their profits home?—We have not considered it in detail, but it might be overcome in that way.

4053. That would be rather dangerous legislation, would it not?—*Mr. Robson*: In the case of public companies you will get pressure by shareholders who want dividends here.

4054. I was not thinking so much of dividends as profits put to reserve?—What I mean is that the shareholders in the United Kingdom wanting dividends from their own company would be inclined to bring pressure to bear upon the directors to bring profits home.

4055. So far as the dividend of the company is concerned, but you would agree that companies are prone to distribute only part of their profits, and quite properly put part to reserve?—Yes.

4056. Supposing they brought home only the part reasonably required for dividends, they would be leaving on the other side the part put to reserve, so it occurred to me in your discussion with Mr. Millard Tucker whether this point I am now putting would not arise, the reserve would tend to be left abroad and not brought home for investment here?—I think the only consideration we have given to the policing of these reserves, if that be the proper word, is that the Special Commissioner method now applying to private companies might be applied if necessary. I do not think we have gone very deeply into it.—*Mr. Lawson*: We felt this proposition would help the balance of payments in that it would attract businesses to set up their headquarters here instead of making a number of businesses want to seek headquarters elsewhere, and from the point of view of general commerce and profits of one sort or another it would tend to help the balance of payments.

4057. Would not the Canadian system help it more so?—It may be. We shall have to consider that.

4058. *Sir Harry Gill*: In paragraph 8, accepting the position there set out regarding the position of incomes in excess of £2,000, have you found by experience or have you any knowledge that there is a disinclination of people to accept higher executive positions?—I think Mr. Robson answered that question in answering the Chairman, that we do not say that it is happening so much at the present time, but we do hear a lot of talk by people who are definitely worried that that type of situation will develop as regards the younger people who are growing up under this system of taxation.

4059. There is not the difficulty today but it is a possible difficulty in the future you are referring to?—*Mr. Robson*: I do not think one could be any more definite than I was in reply to the Chairman.

4060. Paragraph 13 has had a great interest for several of my colleagues and has a great interest for me. I am rather intrigued because it would appear that full acceptance of your paragraph (a) would mean that the assessment of business profits for the future would become the business of the accountant rather than the authorities?—I would not have thought that was really so even more than it is today. The authorities and the accountant both work according to rules which are pretty well recognised between them and I think if paragraph (a) were adopted they would continue to work according to rules which are pretty well recognised between them. I do not think there would be any real difficulty in practice in working on that basis. Theoretically I agree it would be so.

4061. If they are working today on that method what real change is it you are suggesting?—I said they would work according to recognised rules, but those rules which prevail today involve the disallowance of a number of items of expenditure in ascertaining profits which we as accountants think should be allowed as expenses.

4062. And therefore are not in accordance with accepted accounting principles?—The taxed profits are not in accordance with accepted accounting principles to that extent and rather than attempt to put out detailed lists of items which should be allowed that are not now allowed, we prefer to express it simply in that way, that profits should be ascertained on an accepted accounting basis.

4063. Are there accepted accounting principles today, universally accepted?—*Sir Harold Howitt*: On this kind of point I should have thought yes.

4064. On this kind of point, but take another point, I do not want to bring it into discussion, take the very large question which has to be dealt with, increased replacement values and whether that has to be a revenue charge or a capital charge. Is there not a diversity of opinion even among accountants respecting that principle?—*Certainly*.—*Mr. Robson*: Yes, there is.

4065. That is what I am coming to. So far as I know there is, on many of the big issues we have to decide, a diversity of opinion among accountants themselves regarding certain principles, therefore if this was accepted as you put it there would have to be some tribunal set up to get some agreed accounting principles dealing with income tax questions.—*Sir Harold Howitt*: If you are limiting your suggestion that there is a diversity of opinion between accounting bodies to those vexed questions that arise out of rising prices, depreciation and valuations of stock, I would agree, but I should have thought on most other things such as we are talking of in paragraph 13 accounting principles were agreed.

4066. I have mentioned one, there may be others, but even with the accepted methods surely there would have to be some impartial body, including income tax authorities, set up to determine what these should be. Would you agree that a body of people such as you are representing here today could not definitely lay down that these are the principles and that is the end of it?—*Mr. Robson*: I should have thought if 13 (a) were put into law then, if the Inland Revenue and the company were unable to agree in regard to a particular matter, the Inland Revenue would advise the company on the basis the Inland Revenue thought just and the company would appeal to the Special Commissioners or some other body whose evidence would be given as to what was the accountancy principle which was generally accepted and they would take a view on it.

4067. I was thinking before it got to that stage. Surely if the truth of what you are saying is accepted there would have to be some body beforehand which would lay down what these accountancy principles actually were and in that question the income tax authorities would be directly interested and surely their views would be considered at that time?—I should not have thought it necessary to have an ad hoc authority to lay down principles. I should have thought except on these two major points referred to by Sir Harold Howitt just now the practice is sufficiently well settled to enable the Inland Revenue and the taxpayer to reach agreement and if they did not reach agreement to have the matter fought out on appeal before the Commissioners.

4068. Let us take it to the two points on which you now say there is not agreement, how is agreement going to be obtained on these particular questions?—In regard to the taxation aspect I think presumably your Commission will have something to say after having heard all sides of the matter.

4069. And then if we come to a certain decision you will accept our decision as good accountancy practice?—No.

Chairman: Thank you very much we are obliged to you for your help.

The witnesses withdrew

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THE RT. HON. VISCOUNT RUNCIMAN, O.B.E., A.F.C., MR. A. F. HULL AND
MR. C. W. ASTON

[Continued]

THE RT. HON. VISCOUNT RUNCIMAN, O.B.E., A.F.C., MR. A. F. HULL, and MR. C. W. ASTON, accompanied by MR. MARTIN HALL, C.B.E., and MR. H. E. GORICK, C.B.E., on behalf of the General Council of British Shipping, called and examined.

MEMORANDUM SUBMITTED BY THE GENERAL COUNCIL OF BRITISH SHIPPING

I. Introduction

1. The General Council of British Shipping is a joint organisation of the Chamber of Shipping of the United Kingdom and the Liverpool Steam Ship Owners' Association, and thus speaks for the whole industry.

2. The General Council has noted that under its terms of reference the Royal Commission is asked to advise:—

"whether, for the purposes of the National Economy, the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer".

It is with reference to this question that the General Council submits its Memorandum, the purpose of which is to explain why, in the General Council's opinion, the present system of taxation, if continued in force without modification, is not "the best way of raising the required revenue from the taxation of profits and income" in that it must endanger the necessary maintenance in strength of the British mercantile marine.

3. For an island nation such as this, with so large a population, and so incapable of supporting itself from its own internal resources, a healthy and prosperous Shipping Industry is essential. The obligation placed by the national interest on the industry is that of ensuring the continuing existence of an adequate and competitively efficient mercantile marine. Since the coming of the steam ship and earlier, that obligation has been met and in war an instrument essential to victory has twice been placed at the nation's disposal by its shipowners. The drain which is being imposed on its resources by taxation is imperiling the future capability of the industry to perform the essential duty. The seas are free to all and the shipping trade is open to competition from every quarter. There is no home market in shipping to be protected and sheltered. It must operate and hold its own in international markets wherein the test of success is capability to render efficient service at a cost which compares favourably with that of its competitors.

II. Effect on the Industry of Two Wars

4. In the years immediately following the Great War, the Shipping Industry expended on replacement of lost and worn out ships a sum of approximately £350,000,000 of which only £135,000,000 was derived from insurance recoveries for lost vessels. The balance of £215,000,000 was found by the industry out of its own resources but was substantially contributed to by refunds of Excess Profits Duty under the Revenue Obsolescence Agreement of 1922. These replacements were in part effected by new building and in part by purchase from the Government of Government-owned and ex-enemy tonnage. The greater part was purchased at the inflated prices which ruled in the years 1918-21, prices which were so high that the ships concerned required far better trading conditions to enable them to pay their way than existed during the ensuing twenty years.

5. Generally speaking between the wars there was not enough cargo for the ships available and trading results suffered accordingly. World tonnage, partly aided by State subsidies, increased in comparison with 1914 far out of proportion to any increase in world trade, and in the latter part of the period British shipping underwent the worst depression in its history. In fact the great majority of shipping companies failed during the decade preceding the second world war to provide for statutory depreciation. One result of these trading conditions was to be seen in the relatively high age of the British mercantile marine immediately before the war. The history of the industry over this period was one of increasing unattractiveness to capital investment. The tramp section

of the industry was compelled to seek State aid to preserve its existence pending a revival in trade, and the British Shipping (Assistance) Act 1935 was passed authorising a subsidy of £2 m. per annum for the assistance of tramp ships. The subsidy was paid for 1935 and 1936, but was then discontinued owing to the rise in the level of freight. Immediately before the war, another Bill was before Parliament for the extension of State aid in the form of a further tramp subsidy, a liner "Fighting Fund", and grants towards shipbuilding. The shipbuilding grants under this Bill were paid, but its other provisions lapsed on the outbreak of war in 1939.

6. In the second world war, the merchant navy again suffered losses out of all proportion to those of any other industry. Over one half of the tonnage afloat in 1939 was lost by war perils. Since the war ended, the industry has been engaged in replacing these losses. The size of the merchant navy is now approximately back to what it was in 1939. This, however, is due to a large increase in tanker tonnage, and the present dry-cargo fleet is not only below its 1939 strength but it includes a substantial number of stop-gap units in the shape of war built ships, and a high proportion of older ships. Over 40 per cent. of it is represented by ships built in 1939 and earlier, and thus now at least 12 years old. Over 25 per cent. is represented by ships which have passed their 20th year of age. There is thus a very large and difficult problem of replacement facing the industry in the years immediately ahead.

7. The war losses have been replaced at building costs which, when averaged over the whole post-war years, are at least double those of the immediately pre-war years (as stated in paragraph 12 below, present building prices are some three times as great as in the years just before the war) and, in the case of specialised tonnage, at still higher comparative cost. To find the money for that purpose, substantial recourse to reserves has been required. The amount derived from compensation for war losses through the Government War Risks Insurance Scheme fell considerably short of that needed to replace those losses, and in the result reserves which would otherwise have been available for replacement of obsolete tonnage have been heavily depleted. There is no prospect whatever of reduction in replacement cost. All the signs point the other way, namely, to still further increase over the next few years.

8. During the war the industry had no opportunity to accumulate large reserves out of earnings because all its ships were either requisitioned or operated at controlled rates of freight. These controlled rates of freight and the rates of hire payable under the requisitioning arrangements were deliberately restricted by the Government and allowed only 5 per cent. for interest and 5 per cent. for depreciation based on the cost of construction, while in the case of ships over 20 years of age the allowance was reduced by being related to pre-war value as agreed for the War Risks Insurance Scheme. An allowance was sought in the rates of hire towards the increasing cost of shipbuilding that would have to be paid at the end of the war when the requisitioned ships became due for replacement but the industry's proposal in this regard was rejected. That problem was designedly postponed by the Government and left to be dealt with when it arose. The Government in the 1940 Shipping White Paper (Cmd. 6218) stated that it recognised "the necessity of maintaining the British Mercantile Marine in adequate strength and in a position of full competitive efficiency", but when requisition ended, settling was done by the Government in furtherance of this statement and in the result the burden has fallen entirely on the industry. In coping with it, the industry has not even had the assistance of an E.P.T. Post War Refund, a refund which the Chancellor of the Exchequer of the day described as being intended to assist industry to undertake the essential task of reconstruction and readjustment.

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III. Replacement Problem

9. The main problem facing the Industry to-day is the replacement of obsolescent ships which have survived the war. The urgency of this problem is illustrated by the tables in Appendix "A" to this Memorandum.

10. The first of the two tables in that Appendix shows the age distribution of the U.K. foreign-going fleet at 30th June, 1950. Nearly $\frac{1}{4}$ mn. gross tons, or 15 per cent., of the dry-cargo tonnage was over 25 years old, while of the tankers, which have a shorter useful life, over half a million gross tons, or 18 per cent. of the total, was over 20 years of age. This means that some $\frac{1}{4}$ mn. gross tons of shipping was ripe for replacement in the immediate future. At the outbreak of the war in 1939 only 9 per cent. of the dry-cargo tonnage was over 25 years old, and 15 per cent. of the tanker tonnage was over 20 years old, so that despite the immense amount of new building which has taken place the U.K. foreign-going fleet in 1950 is still in this respect worse off than in 1939.

11. The second of the tables in Appendix "A" shows the age distribution of the U.K. coasting and home trade fleet. This indicates that essentially the same problem has to be faced, though the total amount of tonnage involved is considerably smaller.

12. The cost of building a ship to-day is some three times as great as in the years just before the war. The following figures show, for tankers and for tramps and cargo liners, the cost in building costs that took place between 1937 and 1946. It will be seen that in each case the 1946 prices are about $\frac{3}{4}$ times those of 1937, and although the index has so far not been carried beyond 1946, costs since then are estimated to have risen by at least a further one-half, bringing present building prices to about three times the average for the three years 1937-39.

INDEX OF NEW SHIP PRICES

Years delivery	Deep Sea Tankers	Deep Sea Tramps and Cargo Liners
1937	100	100
1938	118	118
1939	156	128
1940	170	136
1941	203	155
1942	225	188
1943	238	200
1944	251	213
1945	255	222
1946	262	246

13. In the case of passenger liners the story is similar. The cost of construction of a large passenger liner was about £50 per ton in 1937 and had risen by 1950 to £150 per ton, since when a further increase has taken place.

14. It may be said that the Shipping Industry is in no different position from other industries inasmuch as it is a well known fact that the cost of all types of plant and machinery has increased very much during the past decade. In the case of the Shipping Industry, however, the General Council believes that the increase in the price level is much larger than in most other industries and there is this important difference, that a ship cannot be replaced by degrees. When the time arrives to scrap a ship the whole asset has to be replaced in one operation. It is as though an hotel with all its public rooms, bedrooms, lifts, furnishings and kitchen equipment were completely destroyed and rebuilt from the foundations upwards. Most other industries can keep their plant up to date by a continuous system of replacing individual items and, as a general rule, the fabric of their factories will last almost indefinitely, and they do not have to be permanently maintained in the same "seaworthy condition" as when new. It has been truly remarked that there can be few industries that require such huge sums to maintain capital equipment which in itself is subject to such rapid obsolescence. In this respect the problem that faces the Shipping Industry in replacing its plant is much more acute than other industries and the impossibility of doing so

in the case of many of the smaller shipping companies can be simply illustrated as follows:—

If a ship which had cost say £100,000 to build in 1939 (for which the comparative cost today is about four times as great) is now in need of replacement, that replacement will cost some £400,000. Between 1939 and 1945 with good management a profit of 10 per cent. per annum might have been earned before making provision for amortising the cost of the ship, and on this basis the total profit earned would be ...	150,000
Between 1946 and 1950, a profit of 40 per cent. per annum (which would be exceptionally high) would yield ...	200,000
	£350,000

But on all profit in excess of wear and tear based on original cost, Income Tax and Profits Tax have to be paid, and these would absorb roughly one-half of £250,000 (i.e. £125,000 less £100,000) ... 125,000 |

Although £400,000 is required for replacement, and even assuming that no dividend was paid in the 20 years, the sum available would only be ... £225,000 |

IV. Submissions

15. It is against this background that the General Council wishes to put forward two propositions:—

A. The first is that, although it is necessary when computing profits assessable to Income Tax to allow as a deduction the cost of amortising capital expenditure over its useful life, the deduction ought not to be less than the value of the wastage of fixed assets employed in the business, such allowance to be based on the current replacement value of the assets.

B. The second is that, owing to the great fluctuations which take place in shipping earnings and their vulnerability to foreign competition, shipping companies should be given wide discretion for taxation purposes to amortise the cost of their ships as quickly as possible in good times so that they may be less likely to have large unabsorbed wear and tear allowances as they had immediately prior to the last war.

16. In assessing profits to taxation, one of the items of expenditure which must be taken into account by way of allowance is the cost of making good the wastage in the capital assets that are used in the venture. Necessary as it is to amortise the cost of the capital assets, this in itself may be insufficient in times of rising prices as it is also necessary to ensure that the charge against profits is adequate to make good the value of the wastage of fixed capital which has occurred in the course of earning the profits during each accounting period. The manner in which the two calculations can be operated side by side is shown in the example forming Appendix "B" to this Memorandum. Only in this way can the replacement of that wastage be made possible, and our productivity be maintained, without which there can be no profits to tax.

17. Variants of this proposition were put before the Committee on the Taxation of Trading Profits, now generally referred to as the Millard Tucker Committee. At that time the Shipping Industry believed that alternative solutions of the problem were available, but during the last two years the continued rise in the cost of ships has forced the General Council to reconsider the subject.

18. The Millard Tucker Report* devotes a good deal of space (paragraphs 95-109) to a system of "revalorisation" which is simply illustrated as follows:—

A machine which cost £1,000 before the war may cost £2,000 to replace today apart from any element of improvement. The advocates of revalorisation claim that before a taxable profit can exist, £2,000 must be allowed to enable the machine to be replaced. The Millard Tucker Committee rejects this argument, on the ground that the system would give a substantial allowance for obsolete plant which might merely be kept for emergency purposes or as a standby and would

* Cmd. 5189.

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give an unjustified benefit to the owner of a business who, on buying new plant, refrains from actually sending the obsolete plant to the scrap heap.

19. The method proposed by the General Council does not in its view have that disadvantage and it does not regard it as a form of "revaluation". Being mainly concerned with ships, the General Council would prefer to explain its proposal by specific reference to ships although, in its view, its proposals would appear to be equally applicable to industry as a whole.

20. The normal useful life of a high class dry cargo ship is 20 years and the rate of wear and tear allowed for taxation purposes (as increased to five-fourths, Para. 1 (1) (b), Part I, Sixth Schedule, Finance Act, 1949*) is 5 per cent. per annum on the original cost of the ship. Higher rates are allowed on refrigerated ships and tankers, but for the purpose of illustrating the point at issue the example is based on a dry cargo ship. Assuming a company with a fleet of 20 similar ships, each built in successive years so that one ship attains age 20 in each year, it would follow that the Company would have to build a replacement ship each year. In other words, the measure of the value of the wastage of fixed capital used in the business would be the cost of building one new ship per annum and, in the view of the General Council, a sum equivalent to the cost of that replacement ship should be allowed as a charge in each year in assessing the profits of the fleet of 20 ships.

21. The principle involved has been explained as simply as possible by assuming a fleet of 20 ships. The same result would be arrived at by calculating an allowance at 5 per cent. per annum on the replacement cost of each ship in the fleet. There follows the general proposition that in calculating the assessable profits of a shipping company, a deduction should be made to cover the wastage of fixed capital looked up in the ships, calculated at the customary percentage recognised for wear and tear purposes, but based on the replacement cost of its fleet; and if this is true of a company with 20 ships it must be equally true for a company with a greater or lesser number of ships.

22. This proposition is very close indeed to one outlined in paragraph 110 of the Millard Tucker Report and the General Council is surprised that the proposition is accorded so little space there. It is rejected on the grounds that:—

(a) It favours the established and stationary business at the expense of the new and expanding one.

(b) It gives relief to the taxpayer who has not replaced his plant since the war and nothing to the taxpayer who has.

(c) The amount of relief which it would give would bear no relation whatever to the needs of particular businesses.

(d) The extent of the relief would depend on the present written down value of the plant, the older the plant and the more in need of replacement, the smaller is its written down value likely to be.

23. In so far as these objections may be raised against the basis proposed by the General Council, the following replies are put forward:—

(a) The system does not favour one business at the expense of another. It proposes that all businesses should be given an allowance for the wastage of fixed assets based on their current replacement cost or the sum needed to amortise the cost of the assets, whichever is the larger.

(b) While the General Council cannot speak with certainty about businesses which may calculate wear and tear on the reducing balance method, it is not the case that the proposed system would give relief to a shipowner who has retained over-age ships since the war because it is inherent in the proposals that no allowance would be given for a ship which has been fully written off, although of course unabsorbed allowances brought forward from previous years would remain the subject of "carry-forward".

(c) The General Council does not agree that the system gives "relief" or that it is in any way related to the "needs of particular businesses". There is no

question of "relief"; it is solely a question of the correct method of calculating taxable profits which, as already asserted, ought to take into account the cost of replacing the wastage of capital assets.

(d) The allowance ought to take into account the age of the plant. Elsewhere in its Report, the Millard Tucker Committee rejects a proposition that the loss in value of pre-war depreciation reserves should be allowed against current and future profits, and points out that what has happened is that those depreciation reserves have lost their value and have resulted in a loss of capital. The General Council accepts that view of the matter and fails to understand why objection should be raised on the ground that the older the plant and the more in need of replacement, the smaller is its written down value likely to be, and consequently the smaller is likely to be the current allowance based on the cost of replacement. That is as it should be.

24. Other objections which may be raised are the following:—

(e) That there may be no need to replace a particular asset and that, therefore, there is no need to make any allowance based on the replacement cost.

This objection is fallacious because what is proposed is not some form of "relief" to enable the assets to be replaced. The proposal is that the wastage of fixed assets which takes place during the year of account, should be ascertained in terms of the replacement value ruling during the year and allowed as a charge before arriving at the year's taxable profits. This allowance is necessary if the productive capacity of the business is to be maintained and, even if it should be unnecessary to replace a particular asset, the assumption is that any continuing business will find the need for alternative items of plant and it will not be able to acquire them unless it has the purchasing power, which in turn can only be ensured if the productive capacity of the business in real terms is maintained.

(f) That before replacement becomes necessary, replacement costs may have fallen and that, in consequence, if allowances are presently based on replacement values which ultimately prove to be too high, then too large an allowance will have been made against taxable profits thus leading to unfair advantages to certain businesses.

The Millard Tucker Committee in its Report has drawn attention to the fact that any system of revaluation would be unsupportable if it insulated industry completely against the fall in value of money (paragraph 103), and that if a business chooses to maintain its depreciation reserves in cash then any fall in the value of those reserves must be a loss of capital. In the face of this argument, which the General Council accepts, it appears to be immaterial that an allowance for wastage of fixed assets based on current replacement values may in the long run prove to be excessive because of a subsequent rise in value of money.

(g) That it is impossible to calculate what will be the replacement value of an item of plant some years hence.

The General Council suggests that this objection is also fallacious because its proposal is not designed to secure and cannot necessarily achieve, an allowance against business profits of the exact sum that will eventually be required to replace each item of plant. Its proposal is concerned, not with the sum ultimately required to replace particular items of plant, but with the annual wastage of capital based on current replacement values.

25. It has been pointed out earlier in this Memorandum that the cost of an asset must in any event be amortised over its life and allowed against taxable profits. Failure to recognise that principle could be as disastrous to the economic well-being of a company as the present disregard of the value of capital wastage as a charge before striking a figure of taxable profit. The General Council is aware that shipping companies have been formed in the last year or two and that they have borrowed money to build new ships. Unless these companies are enabled to amortise the full cost of the ships out of future taxable profits they might well find themselves unable to meet their liabilities.

* Now I.T.A. 1952, s. 281 (1) (b).

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26. At the risk of some repetition the General Council wishes to place on record its disappointment with Chapter 3 of the Millard Tucker Report. Phrases such as the following:

"It will be convenient to mention one objection common to all schemes, namely that they involve giving preferential treatment to the owners of businesses as against other classes of taxpayer." (Paragraph 106.)

"We cannot accept the view that the owner of an existing business who agrees to replace his plant is entitled to preferential treatment over a taxpayer who does not at present carry on any business but is saving in order to set up a business." (Paragraph 104.)

"Moreover a claim for revaluation based on the special importance of industry to the national well-being would equally justify relief to those who began business after the war." (Paragraph 104.)

"It is in our view a formidable objection to revaluation schemes that the relief would be unequal in its benefit and would discriminate in favour of the less deserving." (Paragraph 105.)

serve, in the view of the General Council, to illustrate that the whole chapter is based on the assumption that some form of "relief" is needed by industry and that industry is asking to be placed in a better position than other taxpayers. It is fundamental that one of the items of cost which should be allowed in arriving at taxable profits is the cost of making good the wastage of capital assets used up in the course of earning profits; the cost of making good that wastage must be calculated by reference to the replacement cost during the accounting year to which the profits are related.

27. It is suggested that the true position is that:—

(i) No taxable profit can exist until provision has been made for amortising the cost of fixed assets employed, and that

(ii) If in times of inflation the cost of making good the wastage of fixed assets year by year is greater than the amount required under (i), then the excess must also be allowed as a charge.

28. The second submission of the General Council (B of paragraph 15 of this Memorandum) is that, owing to the great fluctuations which take place in shipping earnings and their vulnerability to foreign competition, shipping companies should be given wide discretion to amortise the cost of their ships as quickly as possible in good times, so that they may be less likely to have large unabsorbed wear and tear allowances such as they had immediately prior to the last war.

29. In its evidence to the Millard Tucker Committee the Industry proposed that losses and unabsorbed wear and tear and initial allowances should be available for reclaiming tax paid on profits of previous years up to a maximum of six years. This proposal was advanced with the special needs of shipping companies particularly in mind, but was rejected by the Committee on practical grounds. The General Council feels, however, that it must again present the special need of the Shipping Industry for some modification of the general taxation practice to meet the fluctuating nature of shipping profits. Accordingly it proposes the above alternative procedure which would achieve substantially similar results without the objection inherent in retrospective adjustments of profits.

30. Whether or not the Royal Commission feels able to recommend that, for industry as a whole, taxable profits should be computed after deducting the wastage of fixed assets calculated at current values, the cost of plant must in any event be amortised out of profits; the recommendation that shipping companies should be allowed to amortise that cost as quickly as they please does not mean that in the long run the amounts to be allowed for amortisation will exceed the original cost. In total the allowances will be precisely the same as at present but, because of the fluctuations in shipping companies' earnings and the risks they run of long periods of depression, they should be allowed to amortise the cost of their ships as and when earnings are available.

31. It will be seen from the Example which forms Appendix "C" that the foregoing proposal can be put into operation side by side with the earlier proposal that

profits should be charged with the annual wastage of capital based on current replacement values. It would be only the annual wastage calculated at percentages related to normal useful life which would be valued by reference to current replacement costs. Such revaluation would not apply to anything additional which might be written off the cost of a ship to accelerate the normal amortisation.

32. As shown in paragraph 10 and in the first table in Appendix "A" there are some 2½ mn. tons of old ships in the foreign-going trades. At £90 per gross ton (the average cost per ton of vessels on order and under construction in U.K. shipyards for British owners at 31st March, 1951) the replacement of this tonnage represents an outlay of £220 mn. The replacement is the near future of the further 1½ mn. tons of foreign-going dry-cargo vessels between 20 and 25 years of age will involve, at current prices, a further outlay of £110 mn. These estimates are necessarily approximate, since the average cost figure is based on the vessels now on order or under construction, and building costs are different for the several classes of tonnage.

33. Owners must find these large sums if they are to continue in business and they should be entitled to a reasonable prospect of being able to recover them out of future profits. Although, in the case of most sections of the industry, present earnings are good, there must inevitably come an end of the trade cycle and there remains the underlying fear that at any time freight rates may fall to a point at which depreciation cannot be found on ships which are built at to-day's high building costs.

34. The shortage of coal exports has caused a change in the pattern of tramp shipping business. It is no longer possible for ships to carry cargoes of coal from this country and to return with bulk cargoes of wheat, etc., on the same scale as formerly. But there is a demand for tankers and a good deal of scope for bold experiment in entering a different trade and seeking to produce better types of ships or perhaps ships which can handle oil as well as other cargoes. At the present time many tankers are earning sufficient profits to enable their cost to be written off in about seven years but, for Income Tax purposes, their owners are obliged to spread the cost over 16 years and even while initial allowances were being granted the period was 10 years. The General Council feels sure that shipowners would be encouraged to embark upon experimental projects with their greater attendant risks if they knew in advance that they would be permitted to write off the cost of new ships as quickly as profits permitted.

35. While initial allowances are operative, they provide a valuable palliative but they cannot be a complete answer to the problem facing the Shipping Industry. A very substantial proportion of the merchant fleet is owned by companies which, in 1950, had unabsorbed wear and tear and initial allowances. In other words, during the period over which the allowances had fallen due, those companies had not earned sufficient profits to enable them to take full advantage of the allowances. Yet that does not necessarily mean that between 1946 (when initial allowances were introduced) and 1950 profits had not been sufficient to cover the allowances. For example, in 1947 and 1948 a company may well have earned profits which it may have placed to reserve against rebuilding expenditure incurred in 1949 and 1950. By our present Income Tax law, however, it is called upon to pay tax on those profits so placed to reserve at that time and it is deterred from bringing them into credit when the wear and tear and initial allowances fall due in respect of the ships built with the aid of those reserves even though it has been unable to take full advantage of such allowances.

36. The remaining companies which had no unabsorbed wear and tear and initial allowances, may be assumed to have paid tax on the profits of their last financial year immediately prior to the beginning of 1951. In other words, their profits for that last financial year exceeded wear and tear at the normal rate of approximately 5 per cent. per annum on the cost of their fleet plus 40 per cent. initial allowance on any capital expenditure during the year. Out of the balance remaining they may be presumed to have allocated sums to Reserve or they may have

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applied amounts to Fleet Depreciation Reserve to amortise the cost of their ships quicker than is permitted for Income Tax purposes. On these sums so placed to reserve, Income Tax and Profits Tax have to be paid and it is the view of the General Council that owing to the uncertain conditions that have to be met by the Shipping Industry, the amounts should not be subjected to taxation, provided they are utilised to amortise the cost of ships in the manner explained in the Example in Appendix "C".

V. Balancing Charges and Allowances

37. Handicapped as shipowners are in their attempts to accumulate sufficient reserves to permit of the replacement of ships as they fall due to be scrapped, the position since 1946 has been even more unsatisfactory when an owner sells a ship or is so unfortunate as to lose one. It was in that year that the system of balancing allowances and balancing charges became operative. When announcing on 25th April, 1944, the impending change the then Chancellor of the Exchequer explained that the substitution of balancing allowances for obsolescence allowances would enable the full cost of plant to be written off against taxable profits whether or not the plant was replaced. He added that as a *quid pro quo* he would levy tax on any profit that might arise on the sale of plant for a sum above its value as written down for Income Tax purposes. If the effect had been merely to bring into credit the proceeds of sale when an item of plant was scrapped, the proposal would no doubt have been a measure of rough justice.

38. But the arrangement is quite unsuitable when applied to the sale of ships. Many owners today have obsolescent ships which they would like to replace. Opportunities arise for selling old ships to foreign buyers at good prices. These prices are high in relation to written down values for the same reason that replacement costs are high, i.e. that values are measured in terms of depreciated pounds.

39. Furthermore, the market values of ships vary in different parts of the world as is shown by the following illustrations:—

(i) A ship built in 1926 at a cost believed to have been about £80,000 was sold in 1950 by the South African Government to a private owner for £27,100 and was resold in 1951 to a Japanese operator for £204,000.

(ii) A vessel sold to Japan at £185,000 and for which an import licence was refused, has since been sold to Scandinavian buyers at £140,000.

40. The General Council has noted with interest the following expressions of opinion by the Millard Tucker Committee:—

PARAGRAPH 193.

"... we came to the conclusion that in the main these various claims were particular instances of the general proposition that the Income Tax system should give relief in respect of the wastage of all assets that are used up or consumed in the course of carrying on a business. The validity of this claim as a general principle cannot in our view be impugned".

PARAGRAPH 194.

"In considering the question we have borne in mind that Income Tax is a tax on income, the existing Income Tax Act neither taxes capital gains nor gives relief for capital losses".

41. The General Council has endeavoured to apply these principles, enunciated by the Committee, to the case of ships. It is necessary first of all to explain that before the introduction in 1949 of the present regulations governing the method of calculating the wear and tear allowances, a ship could only be written down to its break-up value. The break-up value of a vessel was computed on the basis of a percentage of prime cost; in the case of a non-refrigerated steamer or motor vessel built between 1923 and 1939 the percentage was 4 per cent. For subsequent years reduced percentages were agreed with the Inland Revenue in recognition of the increased cost of building. The break-up value remained constant throughout the life of the ship, i.e. it was not affected by subsequent capital expenditure or by the sale

of the ship. The difference between the cost and break-up value was allowed for taxation purposes spread over the estimated life of the vessel.

42. Reverting to the first illustration in paragraph 39, a ship built in 1926 and costing perhaps £80,000 would have been written down to its break-up value in 1945. In the view of the General Council the cost of the ship less the break-up value, i.e. £75,800 must be amortised over the life of the ship, and it fails to appreciate why the amortisation allowances should be withdrawn merely because Japanese nationals are ready to pay a fantastic price for an old ship. The difference between the value of a ship as scrap in the U.K. market and the value of the ship in Japan must be a capital profit which ought not to be subject to Income Tax. The General Council has selected what is admittedly an extreme case in order to demonstrate the unsoundness of the alleged principle supporting balancing charges. Inherently, however, the same objection applies to all sales of ships. The value of a ship in the secondhand market, whether it be for scrap or for operating, must depend upon the course of prices in the world markets and has nothing whatever to do with allowances for wear and tear.

43. The General Council can only suppose that the justification for balancing charges lies in the theory that because a purchaser is allowed wear and tear on the cost to him of a secondhand ship (necessarily so) the cash which he pays for the ship must be brought into credit by the seller in computing his taxable profits. This argument is untenable and the General Council regrets to note that it seems to be accepted by the Millard Tucker Committee as, for example, in paragraph 250 of its Report. In the particular case of shipping the theory breaks down because it frequently happens that the purchaser of a secondhand ship is a foreigner who is not in any event subject to British Income Tax.

44. It has already been demonstrated that it is impossible for many owners to accumulate out of trading profits the funds needed to replace their old ships. If they were allowed to sell the latter at good prices and retain the full proceeds in the business, it would be a step towards financing the cost of replacements. But to subject the sale proceeds to a balancing charge merely adds to the difficulties and cannot in the view of the General Council be defended.

45. In its evidence to the Millard Tucker Committee two years ago the Industry accepted the position that a balancing charge on the sale of a ship was more or less inevitable since the introduction of initial allowances. Its view at that time was:—

"We recognise that when the arrangements introduced by the Income Tax Act, 1945, are regarded as a whole, it is difficult to resist a balancing charge in the event of a ship being sold above her written down value, even though under present conditions the 'profit' arises, not through any error in estimating the wear and tear allowed at previous years, but solely through the value of the Pound Sterling being less in terms of goods than it was before the war".

The continued rise in building costs and the high price of ships, both new and secondhand, has forced the General Council to the view that balancing charges on the sale of ships are harmful to the industry. They should be limited in the case of any particular sale to an amount ascertained by deducting from the initial and wear and tear allowances a sum equal to the wear and tear that would have been allowed had there been no initial allowance. If the Royal Commission is able to accept the recommendation that shipping companies should be allowed to amortise the cost of ships as quickly as they please, any balancing charge should be limited to the excess over and above the normal wear and tear allowance of any initial allowance plus wear and tear actually allowed and any additional sum written off.

46. In Appendixes "D" and "E" are set out two examples showing the method proposed for calculating the balancing charge. The first deals with a case where wear and tear is at the normal percentage rate while the second example shows the balancing charge arising when the cost is amortised at a quicker rate than the normal wear and tear.

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47. In its evidence to the Millard Tucker Committee the Industry confined its representations against balancing charges to the effect of these charges when a ship was lost, and on this subject the Committee reported (paragraph 275) :—

"We come to the conclusion that we could not single out these particular circumstances for preferential treatment. There could be no justification for relieving a shipowner from a balancing charge on the loss of a ship and imposing such a charge on other taxpayers who have lost plant or machinery as a result, for example, of a fire or explosion."

The General Council dissents from this reasoning. It may be that other industries did not make representations against balancing charges being levied in the event of their losing assets through a fire or explosion, but that does not mean that balancing charges in such cases are justified. The arguments put forward below by the General Council are, in its view, equally applicable to industry as a whole. The value for which an asset is insured can have so possible bearing upon the wear and tear which takes place and shipowners feel strongly that the present system is wrong, and is having and will have a very adverse effect upon their ability to maintain the tonnage of the mercantile marine. The reasons for this belief are dealt with below in the following order :—

A. Why the loss of a ship almost always results in a balancing charge and almost never in a balancing allowance.

B. Why the resultant balancing charge is considered to be unjustifiable.

C. Options open to a shipowner who wishes to lessen the burden of balancing charges.

48. A. A shipowner's object is insuring his ships against loss in order to ensure that, if they are lost, he can replace them and continue to carry on his business. In deciding upon the value for which to insure his ships an owner will have regard to their age and the probable cost of new ships. Different owners have different methods of deciding upon their insurance value but two things are fairly certain, firstly that the values will be above the Income Tax written down values and not below, and secondly that an owner will not fix his values above what he considers necessary to enable him, with the aid of his available resources, to replace a lost ship. It follows that upon the loss of a ship, a balancing charge is almost certain to be levied and that after paying the relative tax an owner will have less cash than he will require for replacement purposes.

49. B. The value for which a ship is insured can have no relation to the wear and tear allowances that are due, and it is unjust to reduce those allowances if a ship is lost and the insured value (as almost always happens to-day) is greater than the written down value. Wear and tear takes place quite irrespective of the insured value and the proper allowances should be made. It is recognised however, that, if the writing down of a ship were accelerated in accordance with the second submission of the General Council there would be justification for the levying of a balancing charge on a limited amount as suggested in paragraph 45 of this Memorandum.

50. It has been suggested that if insurance premiums are allowed as a business expense, then it is logical for the policy monies to be taxed upon receipt. The General Council takes the opposite view. It is the duty of every shipowner to safeguard his productive capacity and to ensure as far as he humanly can, that if a ship is lost he will be able to replace it. The cost of safeguarding his physical assets is a normal business expense; his capital is capital and should not be subjected to Income Tax.

51. Nor are balancing charges any more logical when viewed against the background of a shipowner's balance sheet. The wear and tear allowances are very rarely held in cash and therefore cannot be withdrawn in the event of the loss of a ship without weakening the owner's finances.

52. C. There are certain courses of action open to owners who wish to mitigate the effect of balancing charges. They are :—

(a) To take out supplementary insurances against the risk of having to pay tax on a balancing charge. Owners feel, however, that they should not have to insure against the risk of incurring a liability which is wrong in principle and at a cost which is twice the apparent rate of premium owing to the fact that the premiums are not allowed as a business expense.

(b) To elect not to pay the tax on the balancing charge, thereby preserving intact the funds intended to replace the lost ship, and to have the balancing charge deducted from the cost of the new ship before calculating future wear and tear allowances. There is no ultimate benefit to the financial position of a business in adopting this course as the effect is merely to spread payment of tax on the balancing charge over a period of years. This merely postpones the evil and does not remedy it.

53. It must be emphasised, however, that these courses of action do no more than mitigate the effects of the balancing charges. They do not remove the additional liability to taxation which those charges impose.

VI. Need for early adjustment in basis of wear and tear allowances

54. The results of an enquiry made by the General Council of a cross section of British shipowners show the magnitude and urgency of the replacement problem facing the Shipping Industry. As the financial information so collected is of a highly confidential character it is dealt with in an Annex to this Memorandum which is separately submitted to the Royal Commission.

55. The figures to which attention is drawn in the Annex coupled with the general submissions of the Industry in this Memorandum demonstrate, in the earnest submission of the General Council, that there is the need for an early adjustment in the basis of calculating wear and tear allowances if the British Mercantile Marine is to be enabled to replace its obsolescent vessels and maintain that necessary state of efficiency which the country demands. It is, therefore, strongly urged that this vital question should form the subject of an Interim Report by the Royal Commission in order that the Chancellor of the Exchequer may take such action as he may decide in the light of the Commission's recommendations and pending its full Report on the many other matters which fall for consideration under its terms of reference.

VII. Conclusion

56. In conclusion the General Council would sum up the position in general terms as under :—

(i) For some time past and for all industry the method of computation of depreciation allowances has in fact vitiated a cardinal principle of a sound taxation system in that, to an ever increasing extent, tax has been exacted not only on profits but on a substantial part of the cost of replacing the wastage of fixed assets necessarily employed in the business.

(ii) The gravity of this aberration depends on a number of variables but mainly on :—

(a) The extent to which the capital of the enterprise resides in its fixed assets.

(b) The size of the individual unit of fixed assets.

(c) The economic length of life of these units.

(d) The extent of currency depreciation during that life.

(e) The rate of tax current.

(iii) In shipping, all the foregoing factors being simultaneously adverse, the position has now been reached that, irrespective of the presence or absence of distributed profits, the wastage of fixed assets, i.e. the tons of worn-out steel and equipment, cannot be replaced and a progressive shrinkage in fleet size and efficiency is certain and with the inevitable sequel.

(iv) The General Council's submissions to overcome these circumstances are :—

A. That although it is necessary when computing profits assessable to Income Tax to allow as a deduction the cost of amortising capital expenditure over

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its useful life, the deduction ought not to be less than the value of the wastage of fixed assets employed in the business, such allowance to be based on the current replacement value of the assets.

B. That, owing to the great fluctuations which take place in shipping earnings and their vulnerability to foreign competition, shipping companies should be given wide discretion for taxation purposes to amortise the cost of their ships as quickly as possible in good times so that they may be less likely to have large unabsorbed wear and tear allowances as they had immediately prior to the last war.

C. That the balancing charges should be limited to the excess, over and above the normal wear and tear allowances, of any initial allowances plus wear and tear actually allowed and any additional sum written off.

(v) These remedies constitute a modification of the present method of computation of depreciation allowance which in the view of the General Council would:—

(a) restate the validity in practice as well as in name of the principle of Income Tax;

(b) prevent and reverse the deterioration in British shipping which has already begun;

(c) constitute a better system, not only of raising, but also of maintaining, the required revenue for the purposes of the National Economy.

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APPENDIX A

AGE DISTRIBUTION OF FOREIGN-GOING VESSELS
OWNED AND REGISTERED IN THE UNITED KINGDOM

30th June, 1950

	Dry-Cargo		Tankers		Total	
	Gross tonnage thousands	Per cent.	Gross tonnage thousands	Per cent.	Gross tonnage thousands	Per cent.
Under 5 years ...	2,453	21.3	746	23.7	3,199	21.8
5—10 " ...	4,041	35.1	1,263	39.5	5,214	36.1
10—15 " ...	1,606	14.0	390	12.4	1,996	13.6
15—20 " ...	336	4.7	191	6.1	527	5.0
20—25 " ...	1,164	10.1	328	10.4	1,492	10.2
25 years and over	1,702	14.8	248	7.9	1,950	13.3
Total ...	11,902	100.0	3,146	100.0	14,648	100.0

AGE DISTRIBUTION OF COASTING AND HOME TRADE VESSELS
OWNED AND REGISTERED IN THE UNITED KINGDOM

30th June, 1950

	Dry-Cargo		Tankers		Total	
	Gross tonnage thousands	Per cent.	Gross tonnage thousands	Per cent.	Gross tonnage thousands	Per cent.
Under 5 years ...	232	21.7	6	12.5	238	31.3
5—10 " ...	179	16.7	14	29.2	193	17.3
10—15 " ...	136	12.7	5	10.4	141	12.6
15—20 " ...	96	9.0	6	12.5	102	9.1
20—25 " ...	121	11.3	4	12.5	125	11.4
25 years and over	306	28.6	11	22.9	317	28.4
Total ...	1,070	100.0	48	100.0	1,118	100.0

APPENDIX B

EXAMPLE OF PROPOSED WEAR AND TEAR ALLOWANCE TAKING
ACCOUNT OF CURRENT REPLACEMENT COST

Cost ...	...	...	...	...	...	...
1st year	Initial Allowance	40 per cent.	160,000			
	Annual Allowance	5 per cent.	20,000	180,000	20,000	1
				220,000		
				20,000	20,000	1½
2nd year	Annual Allowance					
				200,000		
				20,000	20,000	1½
3rd year	do.					
				180,000		
				20,000	20,000	1½
4th year	do.					
				160,000		
				20,000	20,000	1½
5th year	do.					
				140,000		
				20,000	20,000	1½
6th year	do.					
				120,000		
				20,000	20,000	1½
7th year	do.					
				100,000		
				20,000	20,000	2
8th year	do.					
				80,000		
				20,000	20,000	1½
9th year	do.					
				60,000		
				20,000	20,000	1½
10th year	do.					
				40,000		
				20,000	20,000	1
11th year	do.					
				20,000		
				20,000	20,000	1
12th year	do.					
				Nil		
13th year and afterwards					Nil	Nil

APPENDIX C

EXAMPLE OF AMORTISING COST OF SHIP AS AND WHEN PROFITS
PERMIT

	£	Building Cost Index	Current Value of Annual Wastage	Extra Deprecia- tion	Total Allowance
COST IN 1950	400,000				
1st year					
Initial Allowance	160,000	1	160,000		180,000
5 per cent. Annual Allowance	20,000	180,000	30,000	—	
2nd year	220,000				
5 per cent. Annual Allowance	20,000	10,000	14	25,000	35,000
Extra	10,000	30,000		10,000	
3rd year	190,000				
5 per cent. Annual Allowance	20,000	50,000	14	25,000	55,000
Extra	30,000			30,000	
	140,000				

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APPENDIX C—cont.

	£	Building Cost Index.	Current Value of Annual Wastage.	Extra Depreci- ation.	Total Allow- ance.
4th year 5 per cent. Annual Allow- ance	20,000	1½	30,000	60,000	90,000
Extra	60,000				
	80,000				
5th year 5 per cent. Annual Allow- ance	20,000	1½	30,000	10,000	40,000
Extra	10,000				
	30,000				
6th year 5 per cent. Annual Allow- ance	20,000	1½	35,000	10,000	45,000
Extra	10,000				
	30,000				
7th year Annual Allow- ance	NIL				
	NIL		NIL	NIL	NIL

NOTE.—In the above example it is assumed that in the years 2 to 6 the shipowner has earned profits in excess of the statutory wear and tear and initial allowances of at least the sum described as "extra". All allowances would cease when the ship was written down to "nil".

APPENDIX D

EXAMPLE OF BALANCING CHARGE WITH WEAR AND TEAR
ALLOWANCES AT NORMAL PERCENTAGE RATE
(SHIP SOLD AT END OF 14TH YEAR)

Cost				Normal Allowances (After-tax)	Building Cost Index	Current Value of Annual Wastage
1st year						
Initial Allowance	40 per cent.	160,000				
Annual Allowance	5 per cent.	20,000	180,000	20,000	1	20,000
			220,000	20,000		
2nd year	5 per cent.		20,000	20,000	1½	25,000
			200,000	40,000		
3rd year	do.		20,000	20,000	1½	25,000
			180,000	60,000		
4th year	do.		20,000	20,000	1½	30,000
			160,000	80,000		
5th year	do.		20,000	20,000	1½	30,000
			140,000	100,000		
6th year	do.		20,000	20,000	1½	35,000
			120,000	120,000		
7th year	do.		20,000	20,000	1½	35,000
			100,000	140,000		
8th year	do.		20,000	20,000	2	40,000
			80,000	160,000		
9th year	do.		20,000	20,000	1½	35,000
			60,000	180,000		

APPENDIX D—cont.

		Normal Allowances (After-tax)	Building Cost Index	Current Value of Annual Wastage	
10th year	5 per cent.	20,000	20,000	1½	25,000
		40,000	200,000		
11th year	do.	20,000	20,000	1	20,000
		20,000	220,000		
12th year	do.	20,000	20,000	1	20,000
		NIL	240,000		
13th year			20,000		
			260,000		
14th year			20,000		
			280,000		
(A) Sold for ...	£200,000	(B) Sold for ...	£300,000		
Surplus ...	£200,000	Surplus ...	£30,000		
Balancing Charge restricted to £120,000, i.e. Initial Allowance and Annual Allowance ...	£400,000	Balancing Charge	£20,000		
Less: Annual Allowance had no Initial Allowance been granted ...	280,000	No restriction placed on the Balancing Charge as it falls below £120,000 shown opposite.			
	£120,000				

APPENDIX E

EXAMPLE OF BALANCING CHARGE ARISING WHERE DEPRECIATION IS ALLOWED TO BE WRITTEN OFF AS AND WHEN PROFITS PERMIT

	Building Cost Index.	Current Value of Annual Wastage.	Extra Depreci- ation.	Total Allow- ance.
COST IN 1950		£ 400,000		
1st year Initial Allowance 5 per cent. Annual Allowance	160,000	1	160,000	180,000
	20,000	180,000	20,000	
	220,000			
2nd year 5 per cent. Annual Allowance Extra	20,000	10,000	1½	25,000
	190,000			
3rd year 5 per cent. Annual Allowance Extra	20,000	30,000	1½	25,000
	140,000			
4th year 5 per cent. Annual Allowance Extra	20,000	30,000	1½	25,000
	100,000			
5th year 5 per cent. Annual Allowance Extra	20,000	60,000	1½	30,000
	60,000			
Proceeds of Sale		380,000		
Surplus		£300,000		
The Balancing Charge should be restricted to £260,000, i.e. Total Allowances ... £340,000				
Less 4 years' Wear and Tear at 5 per cent. per Annum ... 80,000				
				£260,000

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[Continued]

EXAMINATION OF WITNESSES

4070. Chairman: Lord Runciman, Mr. Hull and Mr. Aston, we are grateful to you for the papers you have put in to us on the subject within the range of our Commission and I can assure you that we have read your documents with great care. Of course one of the major questions you raise, the question of replacement cost, is a subject we have heard a good deal about and had a good deal of evidence on, and I think it therefore makes it easier for us to follow clearly what your position is with regard to it. I really have not much to ask. We can see also from what you have told us what major problems the shipping industry of this country necessarily faces, more particularly after the recent war. There were one or two things which, with your help, I would like to clear up on your paper. In Section II of your first document, you are dealing with the history of the industry there just for our own historical information, you say there in paragraph 4:—

"The balance of £215 million . . ."

That is the difference between what was expended after the Great War and how much was recovered by insurance for lost vessels:—

"was found by the industry out of its own resources but was substantially contributed to by refunds of Excess Profits Duty under the Revenue Obsolescence Agreement of 1922."

Can you give me some idea of how much in fact by that system you did get by way of aid?—Lord Runciman: After the first war? I think probably Mr. Aston would give you a better figure than I can.—Mr. Aston: I have never heard an actual figure of total for the industry as a whole. I only know that one company of which I am aware had about 24 million of relief, one company alone.

4071. Yes. According to your experience it was something on a very substantial scale?—Very definitely.

4072. You make the point later on in this document that no comparable arrangement was available for you at the end of this war?—That is so. I would like to stress in that connection the great difference between that arrangement and the exceptional depreciation allowances which were made for Excess Profits Tax. If I may just explain what happened. The obsolescence allowance in 1920 was not an income tax allowance. It was purely an Excess Profits Duty allowance.

4073. It was by way of refund?—Yes, of Excess Profits Duty, but it did not have to be taken into account for income tax purposes. It was not a deduction from the cost of the ships which were allowed to be deducted for income tax purposes, and in that way it was, if you like, a free gift to industry, not only to the shipping industry but to all industry, and it was not recovered out of subsequent income tax wear and tear allowance. Now, in the excess profits tax the exceptional depreciation was also granted for income tax purposes, and over the life of the assets you do not get more than the original cost of the plant which you had to buy at high prices. There is no free gift on this occasion. Now what I want to suggest, Sir, is that, it is perhaps an early stage to develop this theory, but I did want to suggest that the people who did this thing in 1920 may not have realised exactly what they were doing but it was a rough and ready way of giving industry an allowance to meet the high cost of plant at that time due to the depreciation in currency and it was left in industry; it was not taken out again as we do with initial allowances and exceptional depreciation. That, I think, is the big difference between that occasion and the present.

4074. Yes. While we are on that, there may be one or two general things you want to say in a minute, this system you are referring to after the Great War operated by way, potentially, of a return of some of the excess profits taken during the war from the industry?—That is right.

4075. In effect it was a free grant back of that money?—That is so.

4076. Now, you say that after the present war no such scheme was available. Have you in mind that the system of requisitioning the Merchant Marine during this war and the allowances made to them really removed them

from the scope of Excess Profits Tax?—Very largely it did. As we say, the rates of hire were controlled, the rates of freight were controlled and, as a general rule there was not a lot of excess profits tax paid by the shipping industry.

4077. No.—Lord Runciman: To go back to your original question I am told by Mr. Martin Hill that an estimate of the figure is probably £80 millions, but that can probably be no more than an expression of the order of figure.

4078. That is all I wanted really. The other thing in that Section was, I would like to be quite clear what you mean in paragraph 5 when, referring to the years immediately before the recent war, you say that the great majority of shipping companies failed during the decade preceding the second World War to provide for statutory depreciation. Does that mean that they did not in those years earn enough taxable profits to cover the allowances that they were entitled to under the income tax system?—Yes, Mr. Aston: Yes, that is so.

4079. These were the two questions on the history I was anxious to clear up. Have you any general statement you would like to make in amplification of the general position?—Lord Runciman: Perhaps it might be of assistance to the Commission and not take up too much time if I did refer to one or two general points. I do not think I need weary the Commission by telling them who we are? They have accepted that we do represent British Shipping as a whole, I think we could make good the claim if it were challenged. We are, as you rightly said, perhaps mainly concerned with the problem of replacement which does, when you look at our figures, become a very serious one for the shipping industry. We represent at the moment about 16 million gross tons of shipping which is about one-fifth of the total world tonnage. Fifty years ago the United Kingdom owned over one-half of the total world tonnage. World tonnage to-day is over three times what it was fifty years ago and this country's tonnage has only gone up by two-fifths—to one and two-fifths of what it was then. Of course this is a striking change due to a variety of causes. You clearly cannot count the effect of two major wars but it leaves us in a position where we naturally attach the very highest importance to seeing that our position does not go worse in relation to our foreign competitors. The one essential for that is that we should have a steady programme of tonnage replacement, and that is really why we concentrated on that perhaps more than on anything else; and why, to some extent, we may be tempted to feel, as every industry feels no doubt, that our case is even more notable than that perhaps of some other people. We naturally would not wish the Commission to infer that because we do not talk about the level of taxation we are not concerned with it.

4080. No.—It is quite obvious that if the level of taxation were negligible these problems would be negligible too, but we have, after all the level is everybody's business, concentrated on the matter which we think is more our own immediate concern. It is fairly obvious that of the shipping industry's total assets, the vast portion consists of ships, and that it is adequate allowance for the replacement of ships we are really concerned with. And the other point which strikes us very much practically about ships is that each ship is a single unit of plant, a very expensive unit, and you cannot replace bits of it at a time. When the ship is gone, it is gone completely; there is nothing where it was before. It is not like a factory where you may have the building left or you may have the land left; you have nothing at all. Your replacement therefore is a total replacement, and you have these extremely expensive large items of plant which wear out in a little over 20 years completely and have to be completely replaced. It was with those considerations in mind that we particularly asked first that the calculation of depreciation allowances shall be allied to the current cost of annual wastage, and second that the rules for granting the allowances shall be so revised that a shipping company at any rate can make the most effective use of the allowances to which it is entitled. I might perhaps add that what is at the back of one's mind is that shipping fluctuates more than many trades is subject to really violent fluctuations of prosperity and the opposite, and it is said,

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[Continued]

I do not quote it as anything more than being said, that in every ten years three good ones have to pay for seven bad ones. I think it is not very far out as a really rough estimate, and therefore there would be considerable advantage clearly in being able to make a proper provision during the good years which you may not be able to make during the bad ones.

In paragraph 55 of the main memorandum we submit that a revision of the basis for calculating depreciation allowances is so urgently necessary that the Commission might well think it proper to deal with it in an interim report, and we would like to go on record as saying that we very much hope this may be possible. In fact a number of bodies representing industry have drawn attention to the need for such a revision and that led us to think even before you had said so that it is one of the problems that has been particularly engaging your attention. These really are the chief points that we want to make. There is a further allied submission in the memorandum about balancing charges, and here again I think it is fair to say that it is a fact that each ship is so expensive a single unit of plant that it makes these charges bear particularly heavily on a shipping company as compared perhaps with other industrial concerns. We have submitted a supplementary memorandum*, which invites particular attention to some of the industry's submissions to Mr. Tucker's Committee. This is because we are given to understand that we are not to assume the Royal Commission is fully conversant with all matters which were placed before that Committee. The supplementary memorandum is mainly concerned with alternative suggestions for dealing with our depreciation allowances, to make these allowances more effective, so there is clearly a certain amount of overlapping with the main memorandum which we hope you will forgive, but the two documents together do cover the taxation matters of particular concern to the shipping industry. Then I ought perhaps just to make some reference to an Annex* which accompanied our main memorandum to the Commission. In that annex are the results of an enquiry of what we believe to be a representative cross-section of British shipowners. Our object in it is to give the Commission factual information about the size and importance of the industry's replacement problem, and it is because much of the financial information collected from shipowners for the purposes of that annex is of a confidential nature that we have asked the Commission to be good enough if they would, to treat it and receive it in confidence.

4081. Yes indeed. If there are any questions that any member of the Commission wants to put with regard to these figures we will put them in private.—Thank you very much.

4082. I think I followed very clearly what you were putting to us. As regards this question of the problem of replacement costs as a conception for taxation, I think you put your industry forward as one where, owing to its peculiar circumstances, the large size of individual items of plant, and the fact that you must throw it away completely (it is one of the extreme cases, perhaps the most extreme case), where the problem of using historical cost as time of steeply rising prices is thrown into a very high light. I follow that entirely, but apart from that it really is a question of the right theory to apply, is it not, in estimating depreciation on fixed assets?—Yes, I think that is so.

4083. One sees it naturally very much more vividly in some industries than in others. There is a phrase you use in your memorandum that I think, if I follow your point, really brings it to a head. At paragraph 24 you are arguing as to what exactly is involved in your proposal. I think in regard to some comments made in the Tucker Committee Report you say the proposal is:—

"that the wastage of fixed assets which takes place during the year of account should be ascertained in terms of the replacement value ruling during the year and allowed as a charge before arriving at the year's taxable profits."

That is really what the theory comes to?—Yes.—Mr. Aston: That is so.

* Not reproduced in these Minutes of Evidence.

† *Cad.*, 8189.

4084. Is that a conception of profits that could be said to be used in other circumstances with regard to business profits? Would one ever find in a managerial agreement, for instance, where sometimes reward is based upon the profits of the year, such a conception applied?—I would say not in a managerial agreement; that would have to be interpreted, I imagine, according to the law, and of course the law of the land does not recognise more than historical cost. But I imagine that it would always be open to anyone drafting a managerial agreement to provide how the depreciation should be provided, in fact that is very often referred to. They say the profit according to the accounts, it may say the profit after providing for depreciation.

4085. Yes, I follow that. I really was wondering whether such a way of defining your profits had in fact yet taken its place, as it were, in any managerial agreements you know of?—No, I would not say so, but I would say that this conception of profit is given effect to by shipping companies very largely in their transfer to additional depreciation. And of course this is where we cross swords with our auditors when we want to put additional depreciation aside; they say "Yes, but you must call that a reserve", and we do not like that. We say that we are making a provision for what we think is the depreciation for the year, and if you have seen a shipping company's accounts you will know that they put to tonnage replacement reserve or fleet replacement reserve additional sums over and above the depreciation. That is their recognition of the fact that the depreciation based on cost is not sufficient.

4086. At least it means they are saying to their shareholders "You cannot have this amount of profit, although it is still called profit, distributed to you"?—Exactly.—Lord Runciman: What you are really saying is that this is not a profit.

4087. I agree. It becomes a question of words really. Are these appropriations, these additional appropriations, usually made by some definite calculation, or are they such amounts as available profits make possible to appropriate in that way plus some provision as to what the future may involve?—Mr. Aston: I would not be able to answer for companies in general; I can only say that in my own company we do review what is necessary in the light of what we have put aside.—Mr. Hall: It varies, Sir, of course from year to year according to the level of building costs.

4088. I appreciate that.—Something considered adequate last year would probably be inadequate this year.

4089. That means that you would apply some sort of calculation or index in order to show what greater sum you require?—Indeed yes, within the limit of profit available.—Lord Runciman: That, I think it is fair to say, is particularly true of a liner company rather than a tramp company. I speak primarily as a tramp owner and therefore with great deference in front of Mr. Hall and Mr. Aston. They have programmes of replacement they must maintain if they are to keep going at all. The tramp owner's system is to build as many as he can for the purposes of trade. His basis of allocation therefore may be slightly different.

4090. Now, I wanted to ask you a question about your proposal that in effect once the cost of a new ship has been incurred by a business, they should have, so far as profits are available, an unlimited discretion as to how soon they write it off. That is what it comes to, is it?—Mr. Aston: Yes.

4091. So far as the relationship between themselves and the tax gatherer goes?—Yes.

4092. It is a wide claim in a sense when you are dealing with such very large items of expenditure as the individual ship may be; but if you had the initial allowance scheme restored again in its full force that would go a long way towards meeting the conception which you have put forward in this proposition, would it not?—Yes, I agree it would in some ways. I would like to say this though. We do want to be able to spread backwards.

4093. Yes?—If you reintroduce initial allowances, that is the first thing. As you will see from the figures we have supplied, shipping companies have very large sums

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of unabsorbed initial allowances; well, you cannot build ships with that. We do want to be able to spread the allowances backwards.

4094. I quite appreciate the point about spreading backwards; there are, of course, practical difficulties.—And secondly we do want them to work to the full and to be available against all the income tax we pay and not merely against our Case I assessments. The figures in our second memorandum show that large amounts of tax on investment incomes are being paid despite the fact that you have initial allowances. There is no way of getting that back. And thirdly we do feel very strongly that having once been given the initial allowances they should not be withdrawn.

4095. Yes. You would say, would you, especially with a concern which has to make a constructional programme to operate over a period of years, that the true value of the initial allowances system is lost if it is capable of being withdrawn?—Yes. One visualises perhaps that the price level will remain where it is for the next twenty years, and perhaps in five years' time we will have got so used to the current price level that the then Chancellor will come along and say initial allowances are no longer necessary, prices are not going up, therefore you can withdraw them. If you do that it means that over the years all the initial allowances put into industry have got to be found by industry. I submit it is a quite impossible task. If the price level goes down again, all well and good, then in theory the initial allowances can be given up, but not if they remain stable.

4096. Yes. But eliminating the question of possible use of back profits for allowance, what you refer to, under the initial allowances scheme what it operated, you got 40 per cent. of your expenditure to write off in your first year plus 5 per cent. for the ordinary allowance, so you had 45 per cent. in the first year?—Quite.

4097. Then you had 55 per cent. left to spread over normally at 5 per cent. was it not?—That is right.

4098. So you really had twelve years in which to exhaust your expenditure. As you say half of them might be bad years from the point of view of profit, but you had the right to carry forward into any good year that came along the accumulation of the allowances?—Certainly.

4099. So to that extent it became rather like the right you claim to write off the cost as soon as you can against the profits of a good year?—Not quite, Sir, no, because the amount that we can use at present we do not get until we build a new ship. If I may take as an example a company with five ships that is making fairly substantial profits out of those five ships. It is going to build another ship next year but this year it is making good profits. If it can be allowed to write down the cost of one of those existing ships out of this year's good profits, it is enabled to retain some of the tax which it would otherwise have paid, and the period over which that ship will be written off in future is then reduced.

4100. Yes.—The initial allowance next year may be no good to that company because there may be no profits.—Lord Runciman: It is really the difference between building your ship out of the profit you know you have made and one which you hope you might make one day.

4101. Yes, I see. Once you have more than one unit of ship in your fleet you get greater flexibility?—Mr. Anton: Yes.

4102. And then you raise a separate point with regard to the fact that at present you can only carry forward your allowances against your Schedule D profit, whereas you may have a large investment income out of reserves which at the moment you cannot recognise for the purpose of writing off?—That is so.

4103. Now, may I just ask you to clear up a little for me your objection to the balancing charge? I do not mean you have not argued it here, I follow that, but take me as somebody who is not absolutely persuaded as to the injustice of the thing. The depreciation that you are allowed, not in the permissive sense, but the depreciation which comes properly in as a charge year by year against profits, is itself only a computed assumption as to the amount by which the capital value of your asset has gone down? Would that be right?—I would not

quite accept that, Sir, with respect. I would like to go back to the wording in the Act prior to 1949 which I think has probably been there for a very large number of years. Businesses then were entitled to an allowance for the depreciation in value by reason of wear and tear.

4104. The wear and tear allowance?—Yes, but it was expressed as the depreciated value by reason of wear and tear, and I submit that even though a ship may increase in value through changing currency it must have suffered depreciation in value through wear and tear.

4105. You mean that you isolate the two events completely in your mind; one you treat as an effective charge against revenue, that is the wear and tear, the other one you say is an isolated thing which happens as regards the capital value of the asset?—Yes.

4106. Unless you can treat the two things as wholly isolated in that way you do meet the argument that you realise more at the end than your written-down value shows you have taken, more than was allowed against profits in the past?—I agree, but I do submit that the profit which was realised over and above its depreciated value is a capital profit.

4107. Yes, I follow now.—And if the capital profits are going to be taxed, then I do submit we should have capital losses, the losses that we suffer on our Government paper which we are holding until we can build ships; the loss on all our cash, all our money capital which we have been holding pending building new ships.

4108. You do get, of course, the balancing allowance which is the immediate opposite of the balancing charge.—True.

4109. But is there any difference in your argument then in the question whether the ship is sold for scrap in the United Kingdom or the immediately surrounding countries or in the Far East, because you dwell upon the fact that the market in Japan might be quite different from the scrap market in this country?—It is not so much the scrap market in Japan, it is the ship as a ship in Japan.

4110. Yes?—I suppose in theory one could say perhaps that any difference between the original scrap value of the ship and the scrap value in depreciated pounds should be adjusted. I think if we could get out of this enquiry relief from the main part of the balancing charge we should be very pleased. But I think that even on the scrap value the argument is still tenable that the profit in depreciated pounds should have been set off against any losses that one has incurred in one's money capital.

4111. When you come to your proposition in paragraph 45, you say:—

"The continued rise in building costs and the high price of ships, both new and secondhand, has forced the General Council to the view that balancing charges on the sale of ships are harmful to the industry. They should be limited in the case of any particular sale to an amount ascertained by deducting from the initial and wear and tear allowances a sum equal to the wear and tear that would have been allowed had there been no initial allowance."

The effect of that formula would be to make a balancing charge only on the benefit you had obtained by the initial allowance?—That is so. For the first twelve years it would be the initial allowance, after the twelve years it would be a proportion.

4112. Chairman: Yes. I think that is all. Mr. Millard Tucker?

4113. Mr. Millard Tucker: The Chairman has really put the gist of the questions I wanted to put, but there is just one I would like to ask you just to emphasise the matter and to clear up a point in my own mind. I follow what you say about balancing charges, that the ship with which you started as a new ship has suffered wear and tear throughout its life or until you sell it, and that that is measured by some conventional percentage. You object to the imposition of the balancing charge if you sell that ship at more than its written down value because you say that the whole of the price you receive over and above the written down value is not profit? That is the basis of your objection?—Yes.

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4114. That is partially recognised by the Revenue in the sense that they do not make the balancing charge exceed the amount of allowance you have already had?—Quite.

4115. And you say that is only a partial and not a full recognition?—Yes.

4116. Now, come back, if you would, to the suggestion as to the annual amount of the depreciation allowance. You take up in the course of your memorandum a principle which was laid down in the Tucker Committee with which you do not disagree I gather. It is the first quotation in paragraph 40 of your memorandum. Without reading it in full the effect is this, that the Committee said that in ascertaining the profits of a business it is not enough merely to take trading receipts and set against them trading expenses. You must also set against that balance the amount of any capital expenditure which is used up in the course of that year. Now I suppose you are wholeheartedly in agreement with that principle?—I think so, yes.

4117. And it is repeated at paragraph 194 of the Report. Now come back again to the question of the depreciation allowance. The whole of your case is this, is it not, that in allowing for the annual usage of the capital value of the ship you calculate it on the then value of the ship irrespective of what the cost was to you, is that it?—Yes, that is right.

4118. So that if the ship cost you £100,000 and immediately after it was delivered the market had gone up for ships so that it was worth £200,000, and assuming your percentage rate of depreciation is 5, you would want £10,000 a year depreciation, not £5,000?—Yes, for that year, yes.

4119. And so on throughout the years according to how the value of the ship goes up or down?—Yes.

4120. So that in effect you are asking, are you, for a depreciation allowance on your unrealised capital profit? If the ship cost you £100,000 and then went up to a value of £200,000, you have an unrealised capital profit?—Let me make this point clear. When we speak of value I am not thinking in terms of the value for which you could sell that ship in second-hand markets but in terms of what it would cost to replace the ship. If, as you say, the ship cost £100,000 and if the following year owing to enormous depreciation of currency it would cost £200,000 to build a ship in that year, then I agree, but I am not applying that to the extent of saying if some Jap will pay £200,000 for the ship. . . I am not carrying it to that extent. All we want to do is to be able to replace our ship in the normal course by building.

4121. So that your suggestion is that the capital wastage each year is the percentage figure?—Yes.

4122. Not what the ship actually cost you, not the value at which you could sell it, but the amount you would have to spend to replace it?—That is right, yes.

4123. Is that your true capital loss?—I think it is the measure of the value of the depreciation in that year.

4124. But is it in fact the true amount of the capital used up?—Expressed in pounds of the second year's currency I should have thought it was, because the increase in the cost of the ship can only arise because money is worth less.

4125. Yes.—Mr. Hull: Is it not a fact? You have a ship built in one year costing £100,000, you get depreciation on that figure. If you take delivery of a sister ship costing £200,000 in the next year you get wear and tear on that figure. There is nothing revolutionary in the thought.

4126. No, I just want to make sure that what you are asking for falls within that general principle, with which we all seem to be in agreement.—Mr. Aston: It is not going beyond that. It is the same case as has been put forward by several other bodies.

4127. Mr. Millard Tucker: It really comes to this, that when we are speaking of pounds we may or may not be talking about the same thing depending upon the year which we are talking about?

4128. Mr. Cunningham: What do you visualise as being the position if building costs go up and then come down again before the ship is replaced?—Would you kindly turn to Appendix B of our first memorandum? May I

say frankly that we did not know the answer to this one ourselves when we printed our bound booklet and we have since issued an amendment which we hope you have placed at the bottom of that example. I admit frankly we deliberately avoided this issue in the printed booklet. The solution which I suggest is this, Sir: taking that example as it is now amended, the additional allowances total £100,000, £5,000 being in year 2, £5,000 in year 3, £10,000 in year 4. . .

4129. I can perhaps shorten your answer in this way. Your total allowance would come to £50,000?—Yes.

4130. Your ship cost you £400,000, your building cost comes down by £100,000, so you can rebuild for £400,000. What about the odd £100,000, that is what I want to know?—We are not concerned with the replacement of individual ships. We are concerned with replacement year by year and I think that that is one of the confusions which arises in this thing. It is one of the objections I have to balancing charges. It assumes you have depreciation in your pocket whereas you have not. These extra allowances which have been given in years 2, 3 and 4 and so on, have been used in those years in replacing ships. One has got to look at the depreciation allowance for the business as a whole, not for individual ships.

4131. If you have one ship, it might be one, two or three, but a single ship would give the closest example, with a small number of ships you would not be replacing one every year over this period?—I quite agree with that, but you will be replacing them periodically, and I think with a system. . . . Supposing this revaluation scheme were introduced today, you would never have in hand sufficient allowances to replace any particular ship now because there is so much loss in the past.

4132. That is not solely due to taxation, is it?—I agree.

4133. Not even the biggest factor?—Possibly not, but we do ask that taxation should not make it more difficult. It is difficult enough as it is; we ask that taxation should not make it worse.

4134. On your example, Appendix B, as I say your ship cost £400,000, you get income tax allowance of £200,000, you are postulating being able to replace it for £400,000. The same sort of point can also be drawn from C and D, in both examples the very same point arises—If you were dealing with a single ship company that would be so.

4135. Could it not be put another way, that your theory would only apply if you were dealing with a company that was replacing a ship every year?—No, I do not think it should be limited to that. After all there is no guarantee, for example, that the building cost index will ever come down to one.

4136. No, but your example is founded on the supposition that it does go down to one. Then I wanted to develop the next point arising out of the discussion you have had with Mr. Millard Tucker, whether the true measure is the depreciation amended by the index figure of the year at which you are looking for the depreciation charge, or are you setting out to provide a tax free fund sufficient to replace your ship? The two are not the same.—No, I agree. No, I do not attempt to argue that you should have the full replacement cost of a ship, because that would involve making good to industry all the post losses, and it would further involve making good to industry the further depreciation in value of the depreciation for year 2 when the price level goes down further in year 3.

4137. Yes. It would involve bringing your depreciation curve up to date?—Yes. But, I do not go that far.

4138. I see. Some witnesses have gone that far.—Yes, I know.

4139. But you do not?—No.

4140. But on the other hand you do not do what some witnesses do, bring back the over-provision if the price level falls?—Except this, I do want to make clear we have not taken this example as far as we might have done if the price level goes down below one. Suppose it goes down below one we would agree that the annual allowances should be less than cost with this proviso, that we should always get at least the original cost of the anti-

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The way I suggest it might be done would be by accumulating by way of a memorandum the amounts that you have had in excess of cost and deducting the amounts that you have below cost, and you would never allow that memorandum figure to go into the red. If it went into the red you would then get cost until it again rose above the red.

4141. I see. One last point on this. Do you claim that you ought to have both initial allowances and this additional allowance calculated by reference to your index?—No. I am regarding the calculation by reference to the index as an alternative to initial allowances, because initial allowances have gone for a political reason.

4142. You do not claim that there should be both, some assistance given for the replacement of current ships and then an index allowance on those new ships?—Assistance? I did not quite follow. What is your first allowance?

4143. The initial allowance.—You mean the 40 per cent. which has gone?

4144. Yes.—No, I do not visualize 40 per cent. initial allowance and revaluation.

4145. Thank you.—At the same time we would like permission to write off our ships as quickly as we can.

4146. Which is of course really the same thing as a variable initial allowance?—In a sense it is, I agree.

4147. Mr. Crick: I would like to apologise to you for coming in late, it could not be helped, but if any of my questions touch on matters that have already been dealt with I hope you will tell me so and avoid wasting your time. Would you please confine your answers for the moment to the record of the past. We will come to the future later on. You have, since the war, done a very large amount of replacement and reconstruction, but I gather that that process has been very largely concentrated on tanker tonnage and that the process has not been so marked and rapid in respect of dry cargo tonnage? That is correct, is it?—Yes. The dry cargo fleet has not been restored to its full pre-war capacity, but certain sections of it of course have done very well. The liner section is pretty well back where it was before the war. The main deficiency is in dry cargo tonnage.

4148. To what factors do you attribute those differences?—The liner companies of course have got to keep their trades going; the tramp, they have no particular trade, and they will build according to their capacity.

4149. You would not attribute those differences in any way to financial embarrassments or problems that are confronting some sections but not others in the same degree?—I think I would, because the liners have got their trades to keep up and they will endeavour to build to the full even if they have to risk financial embarrassment, and we do know, for example, that some liner companies are having to borrow today in order to build, whereas the tramp who has no particular trades to safeguard, will be more inclined to limit his building to his financial capacity and other considerations.

4150. It is correct, is it not, that a shipbuilder will prefer to have a variety of ships on his stocks rather than to concentrate his activities on a particular class of ship?—That will depend upon the nature of the shipyard. Some shipyards, of course, are not fitted out for dealing with liners at all. They will not have a joinery shop for example. They will be purely and simply yards designed to deal with plain cargo vessels or even tankers. The big yards, like John Brown, like to have a general mixture of ships. If they have all tankers then of course there is no work for their joinery shops.

4151. It is true that since the war the shipbuilding industry has been fully employed?—Yes.

4152. That brings me to my major question, which is this. Supposing you had had on the financial aspect of the matter nothing to worry about, would the process of rebuilding and reconstruction have gone any further in the past seven years than in fact it has, or would it have been better proportioned or preferable in any way?—I think it is possible there might have been more British orders and fewer foreign orders. You see a large number of orders in the British yards are from foreigners, but I would say it is well-nigh impossible to give a firm

answer to that question. It must depend upon the inclination of particular owners. Certainly some companies would not have built any faster than they have.

4153. You would not agree that the process is being impeded by the physical limitations on production?—I think it has to some extent, perhaps the President would like to deal with this question.—Lord Runciman: I think it would be true to say, it is awfully difficult to speak for the minds of other people in one's own trade, I think it would probably be true to say that more tonnage would have been ordered if there had been prospects of getting them quicker, because after all the interval now between placing the order and getting the ship can be as much as four or five years. A lot of things may have happened during that time. It is more satisfactory if you are going to get your physical assets soon than if you are going to commit yourself to having them and then wait a long time for them. Where, as has been said, you are not so immediately compelled to build to maintain a trade, I think that argument has greater force. You are more able to look ahead from the financial aspect as distinct from looking ahead for the purpose of maintaining your business. You are therefore perhaps less inclined to place an order if you have to wait so long that it is more speculative than you would normally expect it to be in the purposes of your trade.

4154. I will put it in a more direct form if I may. Would it be true to say that the rebuilding programme has not thus far been impeded either by positive lack of finance or inability to obtain finance or because of the implications that it would carry as to the financial structure of the companies concerned?—There are so many things that enter into it, I think it is frightfully difficult to give a straight "yes" or "no" answer to that question. If you imagine no foreign orders in the yards at all you would obviously get a completely different answer because in the ordering of a ship you are making a bargain with the shipbuilder. It does depend what else he has got on his plate. I think it is frightfully difficult to disentangle and put it in a glass case and look at it like that.

4155. Can we look at it in a slightly different way? You say in one of your papers that to find money for the purpose of rebuilding, that is after the second world war, a substantial recourse to reserves has been required. Now I take it that means recourse to depreciation reserves which are mentioned in a different context in your other paper; or are there some other reserves? I am not familiar with the accounting system, but are you referring in that passage to your depreciation reserves or some other?—Both, everything, yes.

4156. Well now, that of course is exactly what the depreciation reserves are there for, is it not?—Mr. Arton: Yes.

4157. And you would not regard that necessity by itself as being anything out of the ordinary? It would be in the course of business as you foresee it over the years, would it not?—Yes, with this proviso of course, that the war losses would accelerate the need to draw on those depreciation reserves, with the result that we have not now as an industry as much in hand as we would like to meet the tonnage which is aging in the ordinary course of events.

4158. I see that point. Now, if I may just repeat that passage "substantial recourse to reserves has been required", that suggests to my mind, I do not know whether it was intentional, that shipping concerns have had to have recourse to other ways of finding money than by drawing upon their own internal resources. Would that be correct?—I know for a fact it is correct with one or two companies, yes.

4159. From what source would they draw those additional funds? There is no question I suppose of having augmented those reserves of yours by insurance recoveries. That is all, I take it, within the broad compass of the word "reserves", is it not?—Yes, I think in the passage you are looking at that is what is intended.

4160. So that it follows that so far as you were not able to have recourse to reserves you were in fact having to raise your money from outside?—Yes.

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4161. Has that been on a large scale?—Probably not, over the industry as a whole. For particular companies it has been on a fairly substantial scale I would say.

4162. Has it been in the form of debt or capital, properly speaking?—No, it has been in the form of borrowing, not new share capital.

4163. So that within the limits of its scope it has perhaps created some distortion of the financial structure of the companies concerned?—Yes, for the time being.

4164. But I gather from the moderation of your answers that you would not claim that up to the present any serious financial difficulties have been created by this problem of rebuilding?—No, I think that is probably true. What we are looking at is the future now.—*Lord Runciman*: I think it would be true to say certainly of one or two companies and perhaps more particularly tramp companies, that they have used up all their resources and still have not got the tonnage they started the war with. The tramp, as we have said once or twice, is not under the same compulsion to have a ship on the berth as the liner, so he tends to go on until he has to stop because he has run out of cash, then he stops and is left with fewer ships than he started with. The liner if he runs out of cash may still feel impelled to build and have to borrow. It is the same thing in a sense. What it means is that the money has not been available to replace the physical assets that have gone.

4165. And that you would sacrifice primarily to the rise in the cost of building?—Yes I think so, certainly.

4166. With the tax system added to it?—*Mr. Aston*: That is so.—*Lord Runciman*: Yes, you have a more expensive thing to buy and it is even harder to pay for it than it would be otherwise.—*Mr. Aston*: I think it goes a little further than that because with the present tax structure there is a disinclination to put more capital into the smaller businesses. I have been discussing this recently with one or two of the smaller concerns, what we call the coasting people, and I have been told in several directions that there is a very definite disinclination to put more capital in because of the uncertainty under the present tax system of ever being able to recover it, owing to the fact that you do not know what your future profits are going to be. Present profits are fairly good but you cannot be sure of recovering the cost of your ships out of your present profits.

4167. That is nothing unusual for shipping, is it?—No, it is not, but that is what we want to alter.

4168. What I am getting at in that question is just this, that by the very nature of the trade your earnings must fluctuate violently, must they not?—Shipping profits must, yes.

4169. If you start to build a fleet at the current level of costs, accepting the present tax system, why should fluctuations in earnings affect your prospects; that is nothing new?—I agree, but it is something which we hope this Royal Commission, the first one for thirty years, will do something to alter.

4170. But that irregularity or susceptibility to fluctuation of gross earnings has nothing to do with taxation, has it?—No, but we do suggest that the taxation system should take more account of it. Instead of having to carry forward our losses and wear and tear to the future we should be allowed to recover them out of the past. We argue that a shipping enterprise can only look at its profits over long periods. A year is much too short a time to compute shipping profits, and it is quite unfair to say that because we made a profit in the year I and then a loss for the next 19 years that we have made a taxable profit.

4171. So far as the past is concerned, we have been dealing with that at some length, but would it be true to say this: that the anxieties of industry so far as finance is concerned are concentrated upon the outlook for the immediate future rather than upon the direct consequences of the past?—We are certainly concerned for the future.

4172. That is because you feel that the resources are being so severely entrenched upon that you will have difficulty in maintaining the quality and size of your fleet. Would that be correct?—Yes, that is so.

4173. And also I take it because you feel that the financial structure of the shipping companies is not so good, having regard to the needs of the future, as you would like it to be from the point of view of the general health of the industry?—I would not necessarily say that their financial structure is not so good. They are not so badly off, taken as a whole, but what they are concerned about is that while they are making these good profits they should be allowed to provide for the future.

4174. *Professor Hicks*: Mr. Chairman, I would like to ask a question which might in the process of its being answered get on to the confidential figures. Should I ask the question in general and then see what happens?

4175. *Chairman*: Yes.

4176. *Professor Hicks*: The question I wanted to ask was whether you could enlighten me at all about the quantitative importance, from your point of view, of the various proposals which you put forward. That is to say, which you regard as important and which you regard as relatively minor. Would I be right, just putting it in perfectly general terms, in saying that if this Commission could make some proposal about replacement costs or something drastic about initial allowances, those would be rather big things, but that the points about balancing charges and about carrying forward or back or taking the depreciation allowances at the time suitable to you are relatively minor?—Might I put it this way, Sir? The industry at the present time and for the past few years has been making very good profits, admittedly. Those profits are rapidly coming to an end. We have put forward a variety of proposals designed to ensure that we do not have to pay tax on these good profits and then find ourselves with perhaps ten years of losses or very little profit, as a result of which we cannot recover the benefits of all these unabsorbed initial allowances that we have got, and anything more that may be given in the way of initial allowances in the near future. If one goes back to the thirties there was a period then from about 1930 to 1940 when I do not suppose any shipping company was paying income tax. Now that arose because during the previous decade they were entitled to depreciation allowances on their ships, and their low profits of the twenties, their comparatively low profits, were not sufficient to meet the whole of those wear and tear allowances and they started the 1930 period with unabsorbed allowances. During the 1930 decade they actually made losses and it is on record in one of the reports that over six years the tramps had £10 million of unabsorbed wear and tear in that six years alone without their previous allowances brought forward, and it was not until about half-way through the war that those arrears were wiped off. We do want to see that that does not happen again and, while the industry is making these fairly substantial profits, we do want to see that we can set those off against the bad times we know will arrive one day. Of the various proposals we have put forward to achieve that end we really do not mind which one the Commission selects.

4177. You are thinking very much of unabsorbed allowances which are not now outstanding but which may arise as the result of what may happen in the future?—Both really. There are at present, as we show, very large unabsorbed initial allowances which for some companies are very substantial.

4178. Yes, but spread over the industry as a whole, I can I think quote from the table at the end of Appendix II to your second memorandum, that table shows something of the order of £20 million?—Yes, it is not the whole industry you understand.

4179. No, quite, but that table applies to companies with unabsorbed capital allowances, so I take it the total of the unabsorbed allowances shown in that table is approximately £20 million?—No, not quite. If you will go to our

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[Continued]

confidential Annex and the note at the back of it, you will see that we set down there the proportion of the industry which we have covered, and our total figures cover 80 per cent. of the liners, but only 32 per cent. of the tramps. If you now turn to the second memorandum, the figures which we have there of £10 million unabsorbed allowances for the liners is applicable to 89 per cent. of that section of the industry, and the figure of £467,000 for the tramps is applicable to 32 per cent. of that section.

4180. I see, yes. The total figure for tramps might be very much larger?—We would assume, in the same proportion, it would be roughly three times.

4181. Actually the tramp figure is really pretty small?—It is not nearly so large because there has not been the building, up to the present, in the tramps.

4182. But that total figure, it may be £25 million for the whole thing, would I suppose be very much in the same order of magnitude as the total amount of taxation the industry paid in a year, would it not?—It is hard to say. I am afraid I have no information at all about this.—*Lord Runciman*: One point which I think it perhaps may be helpful to make is that to a certain extent what would have been replacement of tramps has turned into building of tankers. Coal cargoes fell off and oil cargoes came on and there was a tendency for shipping which used to carry coal to carry oil. You do get a certain amount of inevitable confusion between tramp and tanker figures because to some extent, which I would not like to make an estimate of, tramp owners have been replacing what were tramps with tankers.

4183. Would it be right to conclude from what you were just saying that it is not so much a present lack of funds which is the trouble as a feeling that any new money which is invested now is likely to have its profitability extremely drastically cut down by the particular way in which taxation operates in this industry?—*Mr. Aston*: That I think fairly summarizes our feeling on this point.—*Lord Runciman*: I might go perhaps a little bit further than that just to qualify lack of funds. There are funds up to the moment, but as things are now we do not see how we can set aside in what has been regarded as the ordinary processes enough to go on having enough. One may want to go on the market for future new capital for financing expansion and one says "Nobody would look at it under present circumstances". But we do not really see having enough to keep ourselves at our present level.—*Mr. Hull*: The question of profitability is purely secondary.

4184. *Mr. Kaldor*: I suppose the major problems in the industry arise because you are replacing, or a typical company replaces, ships at very infrequent intervals?—*Mr. Aston*: That depends of course entirely upon the size of the company. If the company is large enough it likes to build a ship a year.

4185. But then this problem that you mentioned earlier, of the industry having suffered owing to the fact that its depreciation provisions, which had accumulated in terms of cash and gilt-edged investments, had depreciated in value, that would have applied to the companies which do not build a ship a year?—Yes, but it affects everybody because one must always have a substantial fund in hand. It is not the slightest good ordering a liner which is going to cost £2 million if you have not a very reasonable prospect of having that money to pay for the ship.

4186. If you ordered a ship a year you would need to have it in hand every year, so to speak?—A little more than that, because a ship will take perhaps two years to build even in the best of times and if you have to wait for materials it will be even longer, and you must keep a substantial fund in hand because there is no guarantee that over the period the ship is being built you will go on earning substantial profits.

4187. Is there a sort of rule of thumb or anything like that in the industry as to what is the proportion of the total resources which it is prudent to keep in liquid form?—No, none at all.—*Lord Runciman*: If I might go back to the ship a year, it is really much more a fashion of speech than a strict rule. In fact you do not and you

cannot for a number of good practical reasons have a completely regular ship a year replacement programme. It would average out a ship a year no doubt with a 20-ship company, but you would probably build your ships in classes, two or three together, because you want to run them in with each other on a schedule, or it may be that you can get two or three berths at a time and another time the shipyard will be full and you cannot. It is not so simple as a musical box that you wind up and it plays to the tune of one ship a year until it runs down. It is very much a fashion of talking and cannot in practice be taken as a literal guide to one's conduct, and indeed, as *Mr. Hull* has just remarked, it would be more than one ship a year sometimes, and you would probably build twice as many ships in one year as in another.

4188. By and large the shipping companies you mention will now have fewer ships than they had before the war, and nothing to set off against this. They suffered largely because they kept a large part of their resources in monetary form?—Yes, I think that is true. What they have been saving up to buy ships with is not worth as much as it was at either end, or perhaps the same end.

4189. Is there any opposite gain to the shipping industry arising out of the inflation as far as borrowed capital is concerned?—*Mr. Aston*: There is very little borrowed capital in the shipping industry, it is a thing we do not like, times are too uncertain. We do not like mortgaging our ships, but it has to be done sometimes. There is one well-known case of a company which paid off a loan during the war, that is the only one I can recall.

4190. It is not usual to have debentures outstanding?—There are a certain number of companies which have debenture stock.

4191. It is not large?—No.

4192. I gather from what you said in answer to Professor Hicks, your point is that the profits earned after the war have been adequate to meet such capital expenditure commitments as you have had?—By and large I would say that is largely true, yes.—*Lord Runciman*: It is the profits earned after the war plus what one had at the end of the war. That would be a fairer way of putting it. One has to dip into the past.

4193. Yes, but I assume you did after the war have a concentrated period of rebuilding because during the war there was no normal replacement at all, so that it would be right for such a period to use reserves for the purposes of replacement?—Yes, that would be true.

4194. But your main concern is that if in future profits were to fall, due to changes in the general business situation, then the present regulations do not allow you to make use of your unabsorbed initial allowances until such times that you make profits again, so to speak, in the still further future?—*Mr. Aston*: Yes, but it is a little more than the general situation because shipping may experience very big slumps at a time when business in general is running along on a fairly even keel, because we are so open to foreign competition.

4195. You have now commitments already made for new ships which will not be delivered before five years ahead?—Yes.

4196. Would any cash problem arise in respect of those, or are you thinking of the further future?—I would say with what has happened in the last six months there are a lot of companies which are even concerned about the orders they have already placed. In fact I think it is right to say we have heard of orders being cancelled.

4197. So that I suppose from your point of view the most important suggestion appears to be this particular suggestion you made in the supplementary memorandum that unabsorbed initial allowances should be carried backward, rather than carried forward?—Yes, provided initial allowances are re-introduced.

4198. Yes, but there is still a very large amount of unabsorbed initial allowances.—Yes, but unless the initial allowances are re-introduced or something put in their

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THE RT. HON. VISCOUNT RUSKIMAN, O.B.E., A.P.C., MR. A. F. HULL AND
MR. C. W. ARON

[Continued]

place the price level is still up where it is, and we are only getting annual depreciation on the cost of ships built ten years ago.

4199. On ships which were built ten years ago, but you are getting more like the present costs on that part of the tonnage which is replaced after the war.—Yes, but even that of course cost very much less than ships cost to-day. You see, I think it is true to say that the cost of ships, I think we say it in our memorandum, has risen very much more than the average run of plants. For instance, between 1946 and 1952 the building index for a plain ship has doubled from £30 a ton to £60 a ton. The "Economist" tells us that the average price index for plant and machinery has risen from 167 to 285 between 1946 and 1952; that is not double.

4200. To what would you attribute this specially steep rise in shipping costs? Is it just full employment or full capacity working in the shipbuilding industry?—I think it is probably the complicated nature of the ship, there is so much labour in it I imagine, and of course the price of steel has risen probably more than a great many other commodities.

4201. I suppose it has risen more than some commodities but not as much as some other commodities?—Not everything, I agree.

4202. Would I be correct in saying that if you look into the future with some apprehension, the restoration of initial allowances coupled with this suggestion that you made, that it could be set off against past profits when current profits are not sufficient and not on the future profits, would go a long way to assure to your industry the possibility of continuing replacement?—Yes, it would certainly go some way. Mind you, we do think that at the present building cost the initial allowances are not sufficient. In fact, just about the time when the allowances were withdrawn, we were seriously thinking of applying to the Board of Inland Revenue for an increase above 40 per cent.

4203. You mean the rate of 40 per cent. was not sufficient?—Yes, and of course there is the important proviso that we do feel that, in the present state of the law, we are at the mercy of the politicians. The allowances are liable to be withdrawn.

4204. Would it not be right to say that the politicians or rather the Government dispose of them or introduce them according to whether it wishes to stimulate new building?—Yes, that may be, but it is an unfortunate fact that we have to pay tax on profits which we are putting aside for next year's building.

4205. Yes, but when you do build, assuming it is a desirable time to build, you can get the allowance again.—If we can spread the initial allowance backwards and recover the tax we paid this year, all well and good.

4206. Chairman: Before you and your colleagues go there is one question I would like to see if you can answer arising out of several questions which were put to you. Am I right in assuming that with a very considerable rise in the cost of replacing ships and with a heavy annual claim from the Revenue to pay tax when you make profits, that, as I think you anticipate in the future, some companies, perhaps all, will find it impossible to replace their ships out of their retained resources? That I think is the theme of what you have been telling us really. Of course your retained resources are one way of finding the further capital for maintaining your business which is needed when prices rise very much. You need more money to keep the same volume of business going, but supposing you cannot get what you need in the future from your own resources? First of all where will you get it from? I think one of you said that borrowing was not the usual thing in the industry because there was a reluctance to make specific charges on the ships themselves. What do you look to as the source of what further capital you need?—Lord Ruskiman: I think one is almost compelled to say that what we look to is not getting it and having to put up with fewer ships.

4207. That is a very serious thing.—It is. I think it is almost certainly true with the tramp trade, of which I can speak with some knowledge. You see, in the first place even if you accept theoretically that it is a good thing to borrow more money merely to keep the same assets in being, which is an argument perhaps it is unnecessary to develop one way or the other at the moment, I think it is extremely doubtful under conditions as they look like being in the future that you will find it very easy to borrow money for the purposes of building ships under the conditions we are labouring under with the present system of taxation and other matters we are complaining of. In other words, can I go back to the point really of our main submission? If in fact in the few years when we make a good profit we are in a position to set aside enough to keep our replacement programme going against the years when we do not make a profit, it would go an enormously long way to solving our difficulties, even if the price of ships does not fall and even conceivably if it went a little, though not much, higher. Now that a done is machinery as opposed to principle, if I may be allowed to put it so.

4208. But supposing the tramp profits as you say are not sufficient and borrowing does not offer to the lender the kind of security which it is reasonable for him to look to, is there no other source of capital which you think would be available to you?—I cannot think of one myself. If you are going to raise a loan it is of course a question of how you can pay it off. As has already been said, in an industry which does fluctuate as much as shipping, it is extremely difficult to raise loans on terms that are satisfactory to the lender.

4209. If you do not look to loans, what about the capital market in general?—That I did mean to touch on a moment ago. That after all is a question of how attractive the industry is to the investor.

4210. You were applying that to the investor too?—Yes, and what I am saying is that it is not very attractive to the investor as we see it in the near future.

4211. The grave element is what lies behind this. In a time of rising prices you must have more money to keep the same volume of business going.—You are, of course, by the same token, earning more money currently, and if you are allowed to put aside an extra number of pounds because those pounds are depreciated, it comes out the same in the end more or less. If you are making a larger money profit and you can keep the same proportion of that money profit as you did before, then you have more money to pay for an asset that is going to cost more to replace.

4212. Which in turn will make more monetary profit than the asset which it replaces.—If it is continuous depreciation it would.

4213. You are thinking of depreciation of the currency?—It would be the same thing if you are thinking of depreciation of the currency or of a continuous rise in prices. The difficulty again is the long life of the ship and the number of things which can happen in the 20 years she is trading. If I may just repeat the theme I started with, ships are very large units which have a long life, and they have got to be replaced in 2000, and I think that is a very good deal of the difficulty and it does lead, we think, immense force to the argument that whenever you can put something aside you should be free to do so.

4214. Mr. Kaldor: May I just ask one more question. Supposing we wanted some evidence on the fact that following on the withdrawal of the initial allowances there may be a serious falling-off in the rate at which new ships are ordered by British shipping companies, could we get some evidence from you on that? You mentioned something to me just now, in the last six months that there was a very serious falling-off in orders.—Mr. Aron: We expected that you might ask us that question and we have looked at it particularly, but the figures are too indefinite. They are available, but last year for some reason which we do not really understand it was quite exceptional.

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THE RT. HON. VISCOUNT RUNCIMAN, O.B.E., A.F.C., MR. A. F. HULL AND
MR. C. W. ASTON

[Continued]

Perhaps I might just read them out. The total tonnage ordered by British owners in the first quarter of 1951 was 1,100,000 tons, and then roughly 500,000 tons in each of the three following quarters. This year it has been 300,000 tons and 275,000 tons, but we would not suggest that that reduction is necessarily at this stage an indication of a permanent falling-off, because the previous year was so exceptionally high. One cannot really tell over a short period.—*Lord Runciman*: There are very many different things that make you order a ship at a particular time. I think that is what it comes to in practice when you are thinking about it.

4215. If there was such a very serious falling-off I suppose something ought to be done about it before there is an actual falling-off in the rate of building of new ships.—*Mr. Aston*: That is why we feel that this question is of some urgency, because the years go on and we all realise that it is three years since Mr. Milford Tucker started his labours, we have paid three years more tax.

Mr. Milford Tucker: It seems like a century!

Chairman: Thank you very much. Gentlemen, we are very much obliged to you.

The witnesses withdrew.

MINUTES OF EVIDENCE
TAKEN BEFORE THE

16

ROYAL COMMISSION ON
THE TAXATION OF
PROFITS AND INCOME

SIXTEENTH DAY

Friday, 25th July, 1952



WITNESSES

Mr. F. BOWER, C.B.E.	} The Association of British Chambers of Commerce	<i>Questions 4216-4385</i>
Mr. W. J. LUXTON		
Mr. BERTRAM NELSON	} The Society of Incorporated Accountants and Auditors	<i>Questions 4386-4493</i>
Mr. JAMES S. HEATON		



LONDON: HER MAJESTY'S STATIONERY OFFICE
1952

THREE SHILLINGS NET

CP64

TERMS OF REFERENCE
(As amended 11th March, 1952)

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages: to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer: to consider the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden fairly among the individual members of the community: to make recommendations bearing in mind that in the present financial situation it may be necessary to maintain the revenue from profits and income: and, in so far as they make recommendations which would on balance entail a substantial loss of revenue, to indicate an order of priority in which such recommendations should be taken into consideration."

NOTE

For the guidance of intending witnesses the Commission published a list of the main heads under which evidence was invited. They explained that the list was not necessarily exhaustive and that witnesses could put in evidence on questions not specifically mentioned, provided that they fell within the Commission's terms of reference. The list is reproduced below.

A. General social and economic questions

1. Is the present system of taxation satisfactory, or could it be improved, in relation to:—
 - (a) incentives,
 - (b) risk bearing,
 - (c) encouraging savings,
 - (d) the control of inflationary or deflationary tendencies,
 - (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment,
 - (f) its effect on the distribution of personal incomes,
 - (g) other economic and social objectives?

These questions can be considered in relation to the taxation of:—

- (i) salaries and wages (P.A.Y.E.),
- (ii) profits of businesses and self-employments,
- (iii) dividends and other sources of income.

2. Would it be advantageous to link Income Tax with social security payments and contributions?
3. Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

B. Particular matters

4. Is the taxation not drawn too widely or too narrowly in relation to:—
 - (a) the taxation of United Kingdom residents (companies or individuals) on overseas profits,
 - (b) the taxation of non-residents on United Kingdom profits,
 - (c) the definition of residence, etc.?
5. (a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particular—
 - (b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?
6. Is the basis of computing income from property under Schedules A and B satisfactory?
7. Should the present rules about deductions for outgoings and expenses be altered?
8. Are the provisions for relief in respect of double taxation satisfactory?
9. Should the present system of graduation by means of the exemption limit, personal allowances, reduced rate relief and Surtax be altered?
10. Should the existing differentiation between earned and unearned income be extended or reduced?
11. Are alterations necessary in the rules governing personal and other allowances?
12. Should the rules about the taxation of husband and wife be altered (a) as regards aggregation; (b) in any other respect?
13. Should P.A.Y.E. be altered or abolished?
14. Should the principle of deduction at source be extended or restricted?
15. Should the method of assessment to Surtax be altered, and in particular should it be deducted from salaries?
16. Are any alterations desirable in the system of administration and the functions of the various statutory bodies or persons connected with taxation?
17. Are any changes in the provisions against avoidance and evasion desirable?
18. Is any alteration necessary in the rules governing the taxation treatment of special classes of taxpayers (e.g., public corporations, co-operative societies, charities)?

MINUTES OF EVIDENCE TAKEN BEFORE THE ROYAL COMMISSION ON THE TAXATION OF PROFITS AND INCOME

SIXTEENTH DAY

Friday, 25th July, 1952

PRESENT:

THE RT. HON. LORD RADCLIFFE, G.B.E. (Chairman)

MR. W. S. CARRINGTON, F.C.A.

MR. W. F. CRICK

SIR HARRY GILL, J.P.

SIR GEORGE HEYWORTH

MR. N. KALDOR

MR. W. J. KIRWICK

MISS L. S. SUTHERLAND, G.B.E.

MR. J. MILLARD TUCKER, Q.C.

MR. G. WOODCOCK

MR. E. R. BROOKES (Secretary)

MR. D. G. DAYMOND (Assistant Secretary)

MR. F. BOWER, G.B.E. AND MR. W. J. LUTYON, on behalf of the Association of British Chambers of Commerce; called and examined.

EXTRACT FROM MEMORANDUM SUBMITTED BY THE ASSOCIATION OF BRITISH CHAMBERS OF COMMERCE

14, Queen Anne's Gate,
London, S.W.1.
3rd January, 1952.

DEAR SIR,

We beg to submit a note on these subjects in the report of the Committee on the Definition of Taxable Business Profits (Millard Tucker No. 1 Committee) with which we are unable to agree. We hope that the expression of these views will be of assistance to the Commission in its consideration of the Report.

The note now submitted has been adopted by the Executive Council of the Association. The Association, however, is a federation of independent Chambers of Commerce and it is to be expected that there is not complete unanimity on all and every point included in the note. Forty-six Chambers submitted their views. Without counting heads on every item in the Report it is fair to say that there was almost complete unanimity on all the points which are material to the Chambers except on the two points of the basis year and inflation.

On the basis year, while some Chambers would press for a change to the actual year basis as an urgent reform, the majority favour the view expressed in this note.

On inflation thirty-nine Chambers endorse the approach set out in this note; three Chambers, Bristol, Coventry and Slough do not disagree the proposals for stock but differ on fixed assets. The first proposes a reduced rate of tax on the extra depreciation, the second prefers a more practical solution and mentions flexible initial allowances, the third makes no alternative proposals on fixed assets. Three Chambers, Glasgow, Wakefield and Walsall, do not accept the proposals for stock or fixed assets but have no alternative proposal save a general reduction in taxation, while the first prefers relief of tax on profits reserved and used in the business. One Chamber, London, does not disagree in principle, but prefers a broader solution which is set out in para. 24 (a).*

Yours faithfully,

ARTHUR R. KNOWLES,
Secretary-General.

Secretary.

The Royal Commission on Taxation of Profits and Income,
Somerset House, W.C.2.

Comment on the Report of the Committee on the Taxation of Trading Profits

1. The Association submits for the consideration of the Royal Commission additional reasons in support of its evidence to the Committee on matters which the Committee has rejected or referred to the Commission. The order of the comments follows the order of the report itself although some of the points also fall under specific headings suggested by the Commission as "B. Particular Matters". For brevity no reference is made to recommendations by the Committee which the Association

welcomes, or accepts with regret, or on which it feels other witnesses are more closely affected. References are to the paragraphs of the report and not to the summary of recommendations.

9. Inflation (Para. 94-132).—We regret to disagree with the reasoning and the recommendations of the Committee. The witnesses may possibly be at fault in not having presented their case more clearly. Therefore it may be better to say what that case is before trying to answer the detailed objections of the Committee.

10. Unlike other taxpayers who are taxed on their gross income, taxpayers who carry on a trade, business or profession are taxed "on the full amount of the profits or gains". (Require allowances for Schedule A and expenses for Schedule E assessments do not invalidate this general statement.)

In order to ascertain the amount of profits or gains it is necessary to have a properly constructed account of income and expenditure. In a period when the value of money is seriously diminishing, the pounds of to-day are different from the pounds of yesterday, and the pound of tomorrow will be different from both. An income and expenditure account in which the income receipts are expressed in pounds of to-day and the expenses are in pounds of to-day is likely to be right, other things being equal. An income and expenditure account in which income receipts are expressed in pounds of to-day and some expenses are in pounds of to-day and some expenses are in pounds of yesterday, is certain to be wrong. A correction is required to convert the debit for expenses expressed in pounds of yesterday into pounds of to-day so as to be in the same currency as the receipts on the income side. The precise nature of the correction is examined below.

11. It is submitted that the alteration in the value of money since 1938 is sufficiently serious to necessitate a correction. The index of wholesale prices is as follows:

1938 Annual average	100
1939	101
1940	125
1941	151
1942	157
1943	160
1944	164
1945	167
1946	173
1947	189
1948	216
1949	227
1949 December	235
1950 Annual average	239
1950 December	243
1951 January	244
February	241
March	239
April	234
May	233
June	231
July	235
August	219
September	221

* Not reproduced in these Minutes of Evidence.

25 July, 1952]

MR. F. BOWER, C.B.E. AND MR. W. J. LUXTON

[Continued]

There is no credible sign as yet that the trend disclosed by the table will cease or be reversed. Some imported materials have dropped below their peak prices but there are internal wage increases in many industries and public utilities which are still to come.

12. Businesses are different from other taxpayers in that by the nature of their activity they are bound to turn over their property, to sell existing goods and services, and to create new; to use up their fixed capital in the form of buildings, machinery, and transport equipment, and to acquire fresh.

When the value of money is relatively stable it is sufficient to charge the consumption of stock to the trading account at its actual or average cost, and to charge a proportion of the capital expenditure actually spent as a measure of the exhaustion of it during the year. Conventional accounting on these principles assures to business the recovery of its past costs of stocks and fixed assets.

13. When the value of money depreciates seriously it is not sufficient to debit past expenditure in past pounds against receipts in current pounds. To do so penalises business to the extent of the difference between the value of the past pound and the current pound during the time that it takes to turn the asset over. Stock is turned over frequently; fixed assets more slowly. The amount of the prejudice inflicted by not recognising changes in money values is, however, the same for each £100 of capital whether it was originally invested in stocks or in fixed assets. The £100 of stock changes its identity many times during a period of fall in money values and each time it purchases less new stock at higher prices. These successive shrinkings in volume together add up to the same total as the shrinkage in value of £100 originally invested in fixed assets which turn over but once during that period. There is no difference in principle between stock and fixed assets; there is only a difference in timing and frequency in the shrinkings in value. There may be a distinction to be drawn between stock and fixed assets on practical grounds when methods are considered of making the correction of past pounds to current pounds.

14. The widespread shortage of finance which business is experiencing is due to the fact that selling prices have not recovered current costs of manufacturing an equal volume of stocks at higher prices or the current measure of wastage at to-day's prices of fixed equipment. Taxation has assisted this shortage by withdrawing a high proportion of the nominal profits computed in disregard of inflation. But taxation is not responsible for the whole of the shortage. Price controls and defective voluntary price-fixing have contributed. We are only concerned here with the ascertainment of profit for tax purposes.

15. The necessary correction to the income and expenditure is to charge current income with the current costs of consumption of salable stock and with the current cost of the amortisation of the fixed assets.

16. As regards stocks, practical considerations may compel a deviation from principle in many cases. The logical application of the principle would require that the debit against sales for stock consumption should be the replacement cost of the stock so sold. The difference between the replacement cost and the actual cost, should be carried to a capital reserve, and the actual cost credited to the stock account. With some businesses, where the types of product are few and there is a known market price to adopt as replacement value, the principle can be followed.

17. With the great majority of manufacturing concerns and merchant businesses the stocks are too varied, too voluminous, and too detailed to permit of individual treatment. They must be dealt with in the mass. There are two methods in use which broadly have the effect of charging current costs of stock consumption against sales. The first is the practice of valuing stock at a constant or "base" price and writing down purchases to that figure as soon as bought. The Commission will be familiar with the advantages as well as the limitations of that method and it is not necessary to explain it. The second is the procedure adopted in the United States at the option of the taxpayer which values stock on the assumption that it consists of the earliest purchases since the date of election to adopt that method. Stock consumption is charged to the operating account on the assumption

that the latest purchases are sold first. (Last-in-first-out.) This method is not perfect because it does not deal fairly with temporary reductions in volume of stock but it is nearer to the principle of current costs than the assumption that the earliest purchases are sold first. (First-in-first-out.)

It is not necessary to copy the American L.I.F.O. method in all respects. Some of its complications can be avoided. A suggested adaptation is outlined in a technical annex to these notes. (Annex A, Part II.)

18. The correction for the fall in the value of money so far as stocks are concerned should be made in the books of account of the business, so as to avoid duplicate records for tax purposes. Taxpayers should have the liberty to choose one of the three methods mentioned, or a variation of them, namely: (1) to create a capital reserve by charging current replacement costs of stock consumption, (2) to create a L.I.F.O. stock reserve, and (3) to value a normal or "base" stock at a fixed price so long as the business continues. The expression "stocks" which has been used above for brevity includes pecking materials, work stores of fuel, engineers maintenance supplies and small tools, and work in progress which is destined for sale.

19. So far as fixed assets are concerned there are various methods which are available for expressing the change in the value of money. The choice of method would be determined by the efficiency with which the chosen method achieves the purpose of expressing the annual wastage of capital in terms of current pounds. Moreover since a separate record is now kept for tax purposes outside the books of account, the method should fit in with the tax records, unless they are to be completely abandoned in favour of the accounting records. So long as these two objectives are achieved it is not essential to alter the capital values of the fixed assets either in the books or in the tax records.

20. It is in this respect that the United Kingdom system differs from the French, Belgian, and Italian methods. In these countries the charge for depreciation for tax purposes follows the books of account and it was necessary first to "revalorise" the gross value of the asset and the depreciation previously provided in the accounts and to fix a rate to amortise the new net book value over the remaining life of the asset before the figures could be ascertained for tax purposes. Moreover the work of re-calculating the new capital values has to be done each year with each new fall in the value of the currency.

21. The revaluation technique adopted in countries which had to deal with run-away inflation is also unavailable. In such cases the law for restoration of the currency gave directions for the revaluation of the fixed assets, stocks, debtors and creditors, in terms of the new currency as a once time adjustment, and assumed that thereafter the currency would be stable. This method is unsuitable for a steadily and continuously depreciating currency.

22. The desired correction can be made in conformity with the present system of depreciation allowances by varying the annual allowances to correspond with the degree of inflation which has developed during the year. The annual allowances are the wear and tear allowances provided by Rule 6 of Schedule D and the annual allowances provided by the Income Tax Act, 1945, for industrial buildings, agricultural development, mines and oil wells etc., and scientific research capital expenditure under the Finance Act, 1944. There would also be included such further annual allowances as may be provided in conformity with recommendations of the Committee for non-industrial business premises. The system of balancing charges and allowances on the disposal of depreciable assets which is provided by the Income Tax Act, 1945, can be adapted to re-state the figures in terms of the value of the pound in the year of disposal. A note developing this statement is included in Annex A, Part III.

23. Since the witnesses failed to make their case understood to the Committee and possibly over-stated the extent of the correction required to taxable profits, it may be unnecessary to reply to the objections made by the Committee to the case as presented. But it is useful to examine if any of the objections are still applicable to the modified case now presented. The objections stated in summary form are as follows:

(a) "Common to all schemes (para. 100). The schemes involve giving preferential treatment to the owners of a business as against other classes of taxpayers, e.g. a bond holder or a pensioner".

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This rather begs the question by assuming that profits are correctly computed by conventional accounting. If that assumption is rebutted the question has to be examined. The present contention is that one can only arrive at a true profit by setting current expenses against current receipts in the same currency. Then to complete the matter, if profits were assessed on the actual year basis as requested the tax also would be payable in the same currency.

Admitting that the realisable value of stock and fixed assets increases in terms of depreciated pounds as inflation progresses, this increase is not available as profit so long as the business continues as a going concern because it must be re-invested to hold the same volume of assets at higher prices. Business, unlike other taxpayers, is obliged to turn its capital over. Nominal surpluses in depreciated pounds which are locked up in maintaining the productive capacity of the business are not disposable profits. This argument does not necessarily hold good on the cessation or contraction of a business, but any nominal surpluses then arising, so far as they are not already taxed by the existing provisions for including the realisation of stocks in income on liquidation and by the existing provisions for balancing charges on depreciable fixed assets, really come into the discussion in connection with the desirability or otherwise of a general tax on capital profits.

The claim for business is not to maintain the real value of the original capital invested, because the present claim does not immunise the value of stocks and fixed assets from inflation by providing a fund sufficient to ensure their complete replacement. It is a claim to correct the profit and loss account.

As regards the bond holder and the pensioner, and indeed all owners of claims for money, there is no remedy but the cessation of inflation and a restoration of the value of money. Whether some recognition of their loss should be given in taxing their income is a separate question on which no views are expressed beyond the fact that it is irrelevant to the question of computing taxable business profit. The taxable profit after it has entered is open to the same loss as the bond holder unless it is promptly re-invested in real assets, which course is also open to the bond holder, but not to the pensioner.

(b) "A feature of all revaluation schemes is that they benefit an established and stationary business but not a new one or any expansion of an existing one." (Para. 104.)

It is assumed that the meaning of the comment is that new businesses or businesses raising new capital from external sources will receive that capital out of taxed sources, and, if they use it for purchase of fixed assets, will use taxed moneys for that purchase. Existing and stationary businesses on the other hand will be able to use tax-free money for such purchases if they are permitted to accumulate reserves for replacement free of tax.

The comment is misleading. New capital does not necessarily come out of taxed income; it may be a transfer of capital from one investment to another. Even to the extent that it comes out of taxed income that income may have been taxed at various rates of tax.

If the comparison were valid, it would be an argument for giving no depreciation allowance at all—not even the historical cost. At the best it can only be applied to the increased cost of replacement over historical cost because even the historical cost advocates concede that the writing off of the first cost of the asset is a trading loss.

An existing business during a fall in the value of money has been over-taxed if that fall has been ignored and its depreciation reserves have been reduced in value below the value they had when they were created. New capital, on the other hand, may or may not have been reduced in value by inflation before it was paid in, according to the source from which it was derived; no one can tell. The comparison proves nothing and should not have been raised because it leads to confused thinking.

It is clearer to consider which basis treats old and new businesses alike in computing the profits of the year, because it is the profits of the year which are the subject of taxation.

A simple example will illustrate this point. An existing business bought a machine in year 1 for £100 (old). The annual depreciation on a ten year life is £10 (old). By the year 10, prices had so risen that the cost of a similar machine in new condition was £200 (new). Admitting the effect of inflation the annual loss by depreciation in the tenth year is £30 (new).

A new business commencing in the tenth year would need to pay £300 (new) for such a machine. Its loss by depreciation in that year is £30 (new).

The new and the old business would be treated alike in writing off £30 (new) as the annual instalment of depreciation.

Where the old business has lost is that in the previous nine years it had only been allowed £10 (old) a year which, together with £30 (new) for the tenth year, gives it a total allowance of £120 (old and new) against a replacement cost of £300 (new).

(c) "... they give relief to the business which has not replaced its plant since the war but nothing to the business which has. (It would be obviously out of question to make the relief retrospective)." (Para. 105.)

The reasoning set out in the preceding paragraph above seems to be an equally relevant answer to this comment. As regards making the relief retrospective, it is admitted that, on the argument now submitted, relief for insufficient allowances for prior years is not strictly a correction to ascertain the profits of the year. One cannot, however, in fairness ignore the fact that business has been pressing for such a correction to the profits of the year for some time now and that refusal to recognise the justice of it has seriously overtaxed business profits.

To go back to pre-war years would plainly overburden the Exchequer seeing that prices have risen to three times the pre-war level. But there is equity in a suggestion that a correction should be admitted to recognise the rise in prices since April 1949, or the balance sheet closed next before that date.

(d) "Revaluation schemes are open to strong objections on practical grounds." (Para. 106.)

"It is impossible to police the actual re-investment of replacement reserves." (Para. 108.)

The experience of France refutes the first statement. A much more complicated scheme has been operating for the last four years without serious embarrassment to taxpayers or to the tax officers. The objections depend on the nature of the correction suggested. The suggestions contained in Annex A, Part III are not much more involved than the present calculations on historical cost. They have been worked out in detail just to prove that they are workable. If a simpler scheme can be agreed which produces substantially the same result, taxpayers will not object.

The second statement is also a misunderstanding. There is no need to police the re-investment of additional sums provided to augment the depreciation charges. The cash so set aside from receipts can be used for various purposes in the business. There is no need to follow it through. If it is used to repay creditors or to give credit to debtors or simply left as working cash, it is exposed to inflation loss. If it is used to acquire stocks or fixed assets it is automatically picked up in the next correction for stock values or for fixed assets depreciation.

The comment ceases to be relevant when the claim is to correct the profit of the year and not to create reserves for specific replacements.

(e) "Revaluation would give a substantial allowance for obsolete plant which was not in regular use." (Para. 109.)

This comment also is not relevant to a claim to calculate the profit of the year by reference to the true loss by reason of depreciation.

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If the plant had passed its expected term of life before the commencement of the year no allowance would arise. If it was still within its term of life it is quite proper to give a depreciation allowance and therefore an augmented depreciation allowance. The reference to regular use has no bearing on the question of loss by depreciation except to fix the rate. It re-echoes a limitation in Rule 6 which is itself open to criticism as a separate matter.

(f) "The amount of the relief would bear no relation to the needs of the particular businesses. It would depend on the present written down value of the plant; the older the plant and the more in need of replacement, the smaller its written down value would be." (Para. 110.)

This statement conflicts with the preceding one. The conversion of an annual allowance based on past pounds into an allowance in terms of current pounds does not involve a question of needs of particular businesses. On the contrary, it treats all businesses alike. The annual allowance does not depend on the written down value of the plant. On the prime cost basis it is a revalued equal proportion of first cost. On the reducing value basis it is a revalued proportion of the reducing value which goes on for a longer period of years. This Committee statement is more in the nature of a criticism of the reducing value basis than of the suggestion to convert the annual allowance into current pounds.

(g) "Replacement reserves are open to another almost equally strong practical objection, that of deciding what is to be regarded as replacement." (Para. 113.)

This objection ceases to have validity as soon as it is appreciated that the claim is not to create reserves for replacement but to correct the debit to trading account to current costs instead of past costs. The consequence of this correction may be to create capital reserves in the form of stock reserves or of reserves for supplementary depreciation of fixed assets. The funds represented by those reserves are available for any purposes of the business, including the acquisition of stock or fixed assets, but they are not in any sense specific reserves for replacement of like with like.

24. The suggestion made by the Committee to give initial allowances on the acquisition of plant is not a solution to the problem of rising prices, even if the initial allowances are geared up to correspond with the degree of inflation, and the objectionable feature of selection between industries is deleted. The following are some of the reasons:

(a) Initial allowances are not appropriate for buildings. (Para. 126.)

(b) Initial allowances are not a basis for valuing stock in trade.

(c) If the inflation grows worse the initial allowance would grow automatically until at an inflation of eight times the starting point the initial allowance requires to be 774 per cent. of the cost price and thereafter approaches 100 per cent. as the inflation grows. Logically, to give the fallacious cash provision for replacement the initial allowance must always be a sum equal to the difference between the cost of the new asset and the cost of the very first machine (not of the machine last replaced). Its logical end is to write off in the first year the entire cost of the plant which would so distort the annual profits as to require an equalisation reserve to counter-balance it.

(d) To give an initial allowance on the second plant is not a substitute for an augmented depreciation allowance during the life of the first plant. Also there may not be a second plant. If there is no replacement the case collapses. An initial allowance on the second plant is an advance of the allowances which would otherwise be given over the life of the plant; it has to be paid for by smaller allowances over the remainder life.

(e) To use initial allowances as a corrective of bad accounting pins them to that use for the future. This may be in direct conflict with the desire to influence the volume of investment through taxation. They cannot be used to stimulate investment at any time because they would already exist. They cannot be taken

away to discourage investment without leaving the bad accounting without the corrective that they are supposed to be.

(f) Initial allowances are bad in principle. As an interest-free loan they are a mild tax relief which might encourage capital expenditure, other things being equal, but they obscure and do not remedy the underlying cause of inadequate depreciation which lies in rising prices.

ANNEXE A

TECHNICAL ANALYSIS OF A METHOD OF COMPUTING TAXABLE PROFITS TO EXCLUDE INFLATION

Part I—General

Survey of business assets and liabilities

1. The first step in formulating a method of recognising changes in money values is to determine which of the assets (and liabilities) of a business should be selected for adjustment and which left unchanged.

Among the assets no adjustment is suggested for:

(a) Goodwill, because it is not capable of measurement. The greatest method of booking is conjecture. Normally it is only booked if it has been paid for on acquisition of a going concern and very rarely if it has been created by reputation or advertising.

(b) Freehold land or land with unlimited right of possession, because it does not disappear or become exhausted by use. Its value can rise or fall with the market demand but that is not relevant for purposes of depreciation.

(c) Shares in other businesses, because if they are ordinary shares they represent a proportionate part in the equity of another business which would itself be adjusted, and if they are fixed preference shares or debentures they are equivalent to claims for money and not to underlying assets.

(d) Debtors, because they are claims to money. Debtors, bonds and cash would cancel out with creditors taking the business world as a whole, and also in individual businesses they roughly balance.

(e) Cash, because it is money and declines in value as prices rise.

Among the assets an adjustment is called for:

(f) Buildings, which are used for trade purposes including premiums paid for a limited tenure of land.

(g) Machinery of all kinds, including ships, vehicles, and other forms of transport.

(h) Trading stocks of raw materials, semi-processed and fully processed goods. Stocks of engineering stores and spare parts which are held for use either for purposes of construction for sale or for repair and maintenance of existing buildings and machinery, are similar to trading stock.

On the liabilities side of the balance sheet, no adjustment is called for:

(i) Trade creditors, because they correspond with debtors in another enterprise. No adjustment is needed even when creditors exceed debtors and cash in a particular business, because they are money claims.

(j) Loan capital. The owners of loan capital are creditless with a title to money which can only become a title to the underlying assets in the event of default and even then only to the extent of their money claims.

(k) Fixed Preference shares. The owners of fixed preference shares are members of the company. It is open to argument that the debasement of the currency is a factor which was not in contemplation at the time of the contract of association and that the change in relative position compared with the holders of the Ordinary shares should be recognised by an adjustment of the Articles of Association. Against that it can be argued that the preference shareholder made his bargain with his eyes open. In return for greater security he made his choice not to participate in the marginal profit or loss attaching to the equity. Moreover, the share have changed hands since they were issued and some are

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recent issues where the facts were clear. The adjustment, if any, of rights between the members of the company who held fixed preference shares and members who held ordinary shares should be left to the company itself to settle by methods which are open under the Companies Act in the light of its own situation.

In summary, the object of calculating profits by deducting expenses of current value from current receipts can be achieved by adjusting the costs of trading stock and the costs of the manufacturing and distributive equipment to current values.

Whether the adoption of the principle should be optional or compulsory

2. Although it is not strictly logical to the argument, it may overcome some doubts and practical difficulties if the taxpayer had the option to declare his profits on the basis of current costs. It would follow that the option was irrevocable, that it would bind the taxpayer for future years and embrace his stocks and his fixed assets. That is to say, he would choose the principle completely or not at all.

For tax purposes there is no grouping of subsidiary companies except for Profits Tax where it is optional to aggregate the profits of United Kingdom subsidiaries in which the principal company owns 75 per cent. of the Ordinary Shares. It would be necessary to have the same basis of stating the profits in all the members of the elected group.

To leave the taxpayer free to elect or reject the principle of reporting his profits on the basis of current costs has the virtue of putting on the taxpayer the responsibility for his decision. He would need to consider his decision by reference to his view of future price levels, his programme of expansion or of alternative development, and the effect on the business. It would not be merely a desire to claim a present tax benefit. The consequences would be serious enough to assure that it was a responsible decision. Reserves created under this principle would be locked up in the business automatically, and available profits would be smaller during rising prices and larger during falling prices.

Further, no taxpayer could claim the option unless he had the figures and records in complete enough detail to enable the principle to be applied with reasonable accuracy. This does not mean that the administration should reject the election for immaterial gaps in the information. Since the current cost basis has not been admitted in the past and there has been no financial inducement, but rather the contrary, to record cost and dates of purchase of fixed assets, some interval should be given to build up the method of book-keeping to produce the data necessary for the principle.

This obligation to attain a necessary standard of book-keeping would cut out small businesses whose accounting is rough and ready. It would take much of the force out of the criticism that administrative labour would be serious for taxpayers and Inspectors of Taxes to deviate from conventional cost calculations. The keeping of the stock records and the fixed asset records can be done by normal businesses in their stride when once the principles were defined to satisfy accounting and tax requirements.

Part II

Trading Stocks and Maintenance Stores

3. The principle of accounting on the basis of current costs assumes that sales should be related to the current or most recent purchases. In a free market that is the basis of price fixing. To calculate profit in this manner cuts out the distortion due to the time lag between making the purchase plus the processing costs and effecting the sale. It also cuts out the identification of the goods which are purchased with the goods that are sold. Since the sales are deemed to be made out of latest purchases, it follows that the unsold stock consists of the earliest purchases starting with the stock on hand at the date of the election to adopt current costs accounting.

The following is an adaptation of the L.I.F.O. method of stock valuation which is the second of the three alternatives mentioned in para. 18 of this note. Starting with the year for which the taxpayer elects to use the L.I.F.O. method:

First, write up the opening stock from cost-or-market to cost;

Second, value the year end stock both at actual cost prices and at the prices ruling at the beginning of the year. This establishes the percentage rise in prices since the beginning of the year;

Third, measure the movement in volume of the stock during the year by comparing the opening and closing stock both valued at opening prices;

Fourth, if the volume at the end is smaller than at the beginning, the stock at the end is deemed to consist entirely of the stock which was on hand at the beginning. Debit profit and loss and credit stock reserve with a sum equal to the difference between the value of the closing stock valued at cost and valued at opening prices;

Fifth, if on the other hand the stock is greater in volume at the end than at the beginning, the closing stock is deemed to consist primarily of the opening stock plus additions taken in at cost. Debit profit and loss and credit stock reserve with a sum equal to the difference between the opening stock valued at opening prices and a similar volume of closing stock valued at cost.

The closing stock should be stated at cost in the balance sheet and the reserve shows separately either on the liability side or as a deduction from stock valued at cost. During the year the stock consumption would be charged to operating at cost. The reserve would be revised annually and the differences charged or credited to profit and loss. The reserve could be treated as being applicable to the aggregate stock for the purpose of calculating yearly movements. This obviates keeping a date on the annual accretions to or reductions of the reserve.

The above method is based on the system at present in operation in the United States with the following differences:

(1) In the United States the amount of the difference in stock valuation on the L.I.F.O. method and the valuation on full cost method is not disclosed. Since on the "dollar value" method, which is the latest development of the L.I.F.O. method, stock is valued both at cost and at the base L.I.F.O. values, there is no extra work to disclose that difference by stating the gross cost value of the stock and the reserve necessary to reduce it to the L.I.F.O. values.

Moreover, the separate statement of the reserve is needed to provide a safeguard to the taxpayer. Since inflation has already advanced a long way without recognition for tax purposes it would be fair to require that if the cumulative reserve should become a minus quantity owing to a fall in prices the minus should not be added to taxable profits.

(2) In the United States the taxpayer can elect to apply the L.I.F.O. method to some parts of his stock and not to others according as it benefits him. Additional parts can be brought in later, if elected, but no part once elected can be taken out and valued otherwise. This option to pick and choose seems to be inconsistent with the principle, and it seems better to have the election include all stocks or none.

The method suggested does not necessitate the compilation of an official index of prices. In the U.S.A. there is an official index of retail prices for use by departmental stores and other retailers who adopt the L.I.F.O. method, but there is none for other businesses. The price movement is derived from the taxpayer's own costings and is therefore suited to his particular business which a national index could never be because of the arbitrary weighting which has to be adopted and the variation of prices in different parts of the country. Since stock values are now accepted on the taxpayer's accounts if would not open a door to abuse if the calculations, certified by the auditor, were based on the taxpayer's stock list prices. All the figures are cost figures at some date and can be verified by invoices.

Illustrative examples are submitted.

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EXAMPLES OF STOCK RESERVES

Decrease followed by increase in volume of stock

First year	£
Closing stock valued at actual cost	4,900
Closing stock valued at prices ruling at beginning of year	3,600
Price movement during the year	900
Expressed as percentage of opening prices	125%
Opening stock valued at actual cost	4,800
Closing stock valued at opening prices	3,600
Reduction in volume at opening prices	1,200

Since the closing stock is smaller in volume than the opening stock the reserve is restricted to the difference in value between the closing stock at closing prices and the closing stock at opening prices, i.e.—

Closing stock valued at actual cost	4,500
Closing stock valued at opening prices	3,600
Reserve to reduce closing stock to opening prices	900

In the balance sheet the stock would be entered as follows:—

	£	Dr.
Stock at cost	4,500	
Less reserve	900	3,600

Second year

Closing stock valued at actual cost	7,200
Closing stock valued at opening prices	6,000
Price movement during the year	1,200
Expressed as a percentage of opening prices	120%
Opening stock valued at actual cost	4,500
Closing stock valued at opening prices	6,000
Increase in volume at opening prices	1,500
Increase revalued at closing prices $\frac{£1,500 \times 120\%}{100}$	1,800
Opening stock at cost less reserve (see above)	3,600
Net value of closing stock	5,400
Gross value of closing stock	7,200
Cumulative Reserve required for the two years	1,800

Increase followed by decrease in volume of stock

First year	£
Closing stock valued at actual cost	6,000
Closing stock valued at opening prices	4,800
Price movement during the year	1,200
Expressed as a percentage of opening prices	125%
Opening stock valued at actual cost	4,200
Closing stock valued at opening prices	4,800
Increase in volume at opening prices	600
Increase revalued at closing prices $\frac{£600 \times 125\%}{100}$	750
Opening stock at cost	4,200
Net value of closing stock	4,950
Gross value of closing stock	6,000
Reserve required	1,050
In the balance sheet the stock would appear as:—	
Stock at cost	6,000
Less reserve	1,050
	4,950

Second year	£
Closing stock valued at actual cost	4,320
Closing stock valued at opening prices	3,600
	720

Expressed as a percentage of opening prices 120%

Opening stock valued at actual cost	6,000
Closing stock valued at opening prices	3,600

Decrease in volume at opening prices 2,400

The reduction in volume exceeds the increase of the previous year and absorbs part of the initial stock.

Alternative 1. Assume that the decrease absorbs the increase of the purchases of the first year and therefore the stock at the end of the second year is the residue of the opening stock of the first year. On this basis the reserve would be £1,440 as follows:—

End of second year stock at end of first year prices is £3,600. These prices are to the opening prices of the first year as 125 is to 100.

Therefore revalued at opening prices of the first year the value is:—

$3,600 \times \frac{100}{125}$	£ 2,880
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The end of the second year stock at end of the year prices is 4,320

Reserve needed	£1,440
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Alternative 2. The cost of the first year stock can be averaged at the net value (less reserve) of £4,950 and the reduction of volume can be valued at the average price. This would give an end price of

$\frac{3,600}{4,950} \text{ of } £4,950$	£ 2,970
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End of second year stock at end of second year prices is 4,320

Reserve needed	£1,320
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The difference between Alternative 1 and Alternative 2 is that part of the dealer purchases of the first year are assumed to be still in stock at the end of the second year. Alternative 2 is to be preferred so as to avoid recording the years of the successive increases and decreases of volume.

Part III

Fixed Assets Depreciation:

1. General:

(a) The term fixed assets covers machinery of all kinds which now ranks for wear and tear allowances, industrial buildings which now rank for allowances, commercial buildings for which no allowance is now made but for which a depreciation allowance is recommended, premiums paid for losses, and generally all capital assets which are to be depreciated over more years than one under the broad principle recommended by the Committee in para. 259.

(b) The objective is to adapt the existing scheme of allowances to a recognition of the difference in money values between the year of purchase and the year in which the allowance is given.

The practical difficulties arise from:

(c) The disturbance to the annual rate of allowances caused by initial allowances given to fixed assets acquired between April, 1946, and April, 1952.

(d) The co-existence of the prime cost basis of allowances with the reducing value basis.

(e) The grant of allowances part way through the life of the asset, e.g., industrial buildings for 1946-47 and future and commercial buildings from a future date

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(d) The adoption of the current cost principle for calculating annual allowances part way through the life of the asset.

(e) The calculation of the balancing allowance or charge. This is more difficult than the calculation of the annual charge because it necessitates a review of the total life of the asset.

(f) The absence of agreed price statistics for various types of assets over the past years.

(g) The possible deficiency of accounting records.

No ready formula presents itself for the simultaneous solution of these practical difficulties but if the problem is taken to pieces and considered in steps the lines of a scheme may emerge.

2. Prime cost basis assets:

(a) Annual allowance. For this type of asset there is known:

(i) cost and date of purchase;

(ii) current cost of replacing it as new at the end of the year;

(iii) the ratio or percentage of current cost to first cost. This is the price percentage for the year.

Therefore the annual instalment of depreciation on the first cost multiplied by the price percentage for the year is the current cost of depreciation for the year. This sum can differ each year with the rise or fall of the price level for the year in relation to first cost.

(b) Final allowance or charge:

If the asset is scrapped after the end of its expected life and there is no (or no material) disposal value, there is no final adjustment to make. If, however, it is scrapped before it has been fully amortised, there is a final adjustment to make in the year of scrapping which is similar to the calculation on a sale for value which is considered next.

If the asset is sold for a price, a final allowance or charge is due to be calculated.

Assuming the plant is purchased after the date of the election to use current costs, the annual allowances will have been given in various currencies depending on the price level for the year. These need to be converted to the currency of the year of disposal in order to be compared with the disposal proceeds. The residue is the first cost converted to the currency of the year of disposal reduced by the annual allowances similarly converted. The difference between the residue and the sale proceeds is the balancing allowance or charge.

Assuming the plant was purchased before the year of election, the initial and annual allowances will have been given as percentages of first cost for years before the election year and as percentages of a moving converted current cost for the post-election years.

If the plant is scrapped after the end of its expected life with no (or no material) disposal proceeds, no final adjustment is needed.

If the plant is sold for value or scrapped before its time, a final adjustment is needed. As in the case of the plant purchased in or after the election year, each of the annual allowances and the initial allowances need to be converted into the currency of the year of disposal. The pre-election allowances, both initial and annual, would be converted at the full rate of exchange between first cost and the currency of the disposal year regardless of the fact that they were not allowed in the appropriate currency which would have applied if election had been from the start. The sum of the converted allowances deducted from the converted first cost gives the residue in the currency of the year of disposal. The sale proceeds compared with that residue give the final adjustment. The balancing charge, however, should be limited to the allowances actually given without conversion because strictly it is a correction of the allowances given in those years.

Scientific research assets and agricultural development are on a prime cost basis and do not need different treatment.

3. Written down value assets:

A more difficult problem is presented by the assets which are now recorded for tax purposes in a global sum for a group or class of machinery and amortised on the reducing value basis. The absence of knowledge of cost and date of purchase is fatal to a calculation on the same lines as prime cost basis assets. The only known facts are the global written down value based on first cost of acquisitions at unknown dates and therefore of unknown currencies.

Assuming it is quite impossible to estimate cost and date of purchase, the following procedure would give partial relief.

Future movements of money values can be recognised by varying the future annual allowances and by varying the cash proceeds of sales which are deducted from the global figure. The annual allowances would be calculated by taking five-fourths of the agreed percentage of the global sum and by writing that allowance up (or down) in the percentage which the price level at the end of the basis year bore to the price level at the beginning of the basis year for the year of assessment. Only the unadjusted allowance would be deducted from the global written down value because both are in the same currency. In following years the annual allowance would be calculated in the normal way and then adjusted for price changes by reference to the percentage which the price level at the end of the basis year bore to the price level at the beginning of the basis year for the year in which the election was made (not the price level of the preceding year). If an asset was scrapped for no value, no sum is added to or deducted from the global sum of written down values. Any residue of value for that scrapped plant (being unknown but certainly not zero) remains in the global sum and forms part of future annual allowances.

If an asset is sold for value the sale proceeds would be in the currency of the year of disposal. Therefore the sale proceeds which should be deducted from the global written down sum should be converted to the currency of the global sum by reference to the percentage which the currency of the year of disposal bore to the currency of the beginning of the basis year of election.

Since no regard has been paid to price rises before the election year it would be only fair that the addition to the normal annual allowance should be separately recorded and that the cumulative sum of the adjustments should never be a minus quantity.

4. It is not, however, inevitable to follow the above partial method. Certainly for all new plant cost and date of purchase can be recorded. As regards existing plant, the global figure can be analysed into years of purchase by working out the residue of the most recent purchases for as many years back as will produce a total sum equal to the global residue. This only requires to be done once and the element of error is against the taxpayer and in favour of the Revenue because it tends to eliminate the oldest plant with the greatest price differential. When the global residue has thus been broken up into years of purchase, first cost, and allowances given, the calculation can continue on the prime cost basis.

The calculation of depreciation allowances by reference to a global sum on the reducing value basis is a device invented by the Revenue to save arithmetic. It is not a proper accounting method and it cannot be strained to do more than the rough and ready work for which it was devised. No normal business keeps its fixed assets records in that manner. It is a handicap when balancing allowances and charges have to be calculated because the disposals have to be grouped into years of purchase and the complete calculation of the residue has to be done again separately. The method can be made to work with variations in price changes but with some difficulty. It is questionable whether the effort is really necessary.

If a taxpayer elects to adopt the current cost basis for fixed assets he can assume the task of keeping the

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fixed asset records. Every business of any size which is conducted with normal efficiency has its fixed asset records and depreciation reserves so laid out that they are routine work for the office. With initial allowances out of the way the records can be so laid out as to satisfy accounting and tax requirements. For instance, by the method suggested above the assets could be kept in terms of first cost

and amortised in the same terms. The price adjustments to the annual allowances would be an additional sum debited to profit and loss account and credited to a capital reserve, a record of which would be kept on the fixed asset cards or ledgers for each separate asset. This procedure obviates revaluing the assets themselves to reflect price changes from time to time.

EXTRACT FROM FURTHER MEMORANDUM SUBMITTED BY THE ASSOCIATION OF BRITISH CHAMBERS OF COMMERCE

Heading B: PARTICULAR MATTERS

Question 5

"(a) Are there any kinds of profits, or income, which are not charged but should be, or which are charged but should not be?

In particular—

"(b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits, satisfactory?"

2. This item was further elaborated by question and answer in the House of Commons, 6th February, 1952, which made it clear that the terms of reference entitle the Commission to consider the question of charging to Income Tax or Profits Tax any profit ranking as a capital profit under the existing law which might reasonably be brought within the scope of those taxes.

Extension or Contraction of the Meaning of Income

3. The witnesses interpret the question to involve a consideration of the definition of income (or profits). It does not admit consideration of an annual tax on capital nor of a once-for-all levy on capital. It does not envisage a separate tax on advantages, benefits, or increases in wealth which may fall outside the definition of income (or profits) for the purpose of Income Tax or Profits Tax, but could admit a particular rate of tax for any such advantages, benefits, or increases in wealth.

Contraction of the Definition of Income

4. As regards income or profits which are now charged and which should not be charged, the witnesses have previously referred to:

(i) the exclusion of nominal or unreal profits which are due to the general rise in prices;

(ii) the exclusion of all or part of the income or profits which arise overseas.

United States Definition of Income

5. The discussion has been influenced by the suggestion by a political party of a tax on capital profits and by reference to a tax on "capital gains" said to be levied in the United States. It may be relevant to note that there is no separate tax on capital gains in the United States. The general definition of Gross Income includes "gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce or sales or dealings in property whether real or personal growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities or the transaction of any business carried on for gain or profit or gains or profits and income derived from any source whatever." Then Section 117 of the Revenue Code picks out the profits or losses arising from the transfer of certain capital assets defined in the section and prescribes a special treatment for them and alternative rates of tax from the rates laid down for other forms of net income. The inclusion of exceptional profits or gains (and consequently of exceptional losses) in the sweeping definition of income has caused considerable trouble and repeated amendments to the Revenue Code and a satisfactory solution has not yet been found. Also by tacit consent, transactions in personal property, such as motor cars, jewellery, furniture, clothing, are ignored unless they are required for "a gainful purpose." The United States is to some extent embarrassed by the width of its definition of income and provisions are necessary to exclude matters from it. The most recent exclusion is the difference between the market

value at date of death and the value at the date of issue of shares in a company given to an employee as part of his retirement pension.

United Kingdom Definition of Income

6. The United Kingdom situation is different inasmuch as income as such is not defined, but different types of income are described in five schedules and if a particular gain or advantage does not come within the description of any of the schedules the gain or advantage is not chargeable. In particular, the gain must be annual and, in the case of gains from exchanges or transfers of property, there is no charge unless the transaction is part of a trade or the transaction is for the purpose of gain. The residual section is Case VI, Schedule D, which picks up any income not charged under any other Schedule or Case.

No Extension of Income Chargeable under Schedules A, B, and C

7. The income definition for the types of income now charged under Schedules A, B, and C seem to be sufficiently comprehensive and the witnesses can think of nothing in those types of income which is omitted from charge which might be charged. Advantages derived from the ownership of land and natural resources other than the rental value are considered under Schedule D, so as to relate the treatment of the payer with the recipient.

Income Chargeable under Schedule E

8. To take Schedule E next (and leave Schedule D to the last, because it is the most difficult), the definition of remuneration for services offers scope for comment.

There should be omitted the remuneration of a director of a United Kingdom company who is non-resident and whose services are performed abroad. This would reverse the principle of the decision in *MacMillan v. Goss* (24 T.C. 192) and put a director on the same footing as an overseas employee who is not a director.

Per contra, the remuneration should be charged of a resident employee of a non-resident employer if the services are performed in the United Kingdom for more than six months in the tax year.

Benefits in Kind

9. Benefits in kind arising from an employment are not included in chargeable remuneration unless they can be turned into money or unless they are received by a director or by an employee whose remuneration exceeds £2,000. All benefits in kind should, in principle, be included in chargeable income at a valuation, but on practical grounds there should be a rule to exclude relatively unimportant benefits such as meals provided below cost price, tea money for overtime work, suggestion awards, prizes for examinations, participation in bulk buying schemes at preferential rates, free issue of the products of the business for personal use of the employee, where the value is small.

Free board and living accommodation should be valued by agreement with the employer under a discount for restriction of liberty of choice.

Leaving Payments

10. There are included under this head various types of payment made at the end of the employment, the tax treatment of which is not completely logical.

Wages in lieu of notice and compensation for loss of office, which are assured to the employee by the terms of his employment, are presently taxable in the year in which they become due. In practice, wages in lieu of notice are not taxed.

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Wages paid in excess of the amount which would be legally due on notice, and compensation for loss of office which was not contracted for under the terms of the employment, are not now regarded as income. They are regarded as damages paid for loss of the source of income. This is so, whether the sum paid is based on an estimate of what the court would award if the breach of contract were litigated or whether they are based on a calculated scale of a fraction of the remuneration for each year of service.

Leaving gratuities are paid which may or may not be related to the salary and years of service. They are not now regarded as taxable income where the employee has not a right to them by his terms of service.

It is difficult to draw a firm line inside which the receipts are income and outside which they are capital. The test of whether the receipt is provided for by the contract of service is not satisfactory. The terms of service are often not reduced to writing in which case a consistent practice followed by an employer, which was known to the employees, could be said to be a term of service, in spite of statements that the sums were in the discretion of the employer.

Pure damages for breach of contract are capital. All other leaving payments are income in the sense that they arise from employment. This view sets on one side the consideration of whether the payment arises by virtue of carrying on the employment or by virtue of the cessation of it. Having said that, one cannot go on to say that such other payments must necessarily be taxable income. Leaving payments form part of the problem of retirement pensions, whether they are paid late or early in life.

Retirement Benefits

11. The tax-free benefits arising from retirement schemes are under consideration by the second Milford Tucker Committee. It is not necessary to repeat the representations made to it.

National Insurance Act Receipts

12. Unemployment benefit, sickness benefit, and maternity benefit receivable by persons insured under the National Insurance Act are by nature income. Section 24, Finance Act, 1949 (section 225, Income Tax Act, 1952) was wrong in principle in exempting them.

The witnesses have endeavoured, in their evidence to the Milford Tucker Committee on Retirement Benefits, to establish the principle that contributions to purchase a retirement pension should be deducted from taxable income and that the pension should be treated as taxable income when it is payable. They therefore most deprecate a provision which goes in the opposite direction, especially as it has the effect of increasing the tax charge on the contributors. It is recognised that there are administrative difficulties in tracing and taxing the benefits, which may, to some extent, justify the deviation from principle, but those difficulties arise from the practice of making tax-deduction under P.A.Y.E. the final assessment. Elsewhere, under Question 13, the witnesses have suggested a modification of this practice which, if adopted, would obviate the administrative difficulty of taxing the benefits under the National Insurance Act, and enable the desired principle to be preserved.

Income under Schedule D

13. The main discussion of amendments to the definition of income centres round benefits or surpluses which, if they were income, would fall to be assessed under Schedule D.

Casual or sporadic receipts for services rendered are already included in taxable income.

Premiums and Discounts on Loans

14. Premiums on the repayment of loans, including repayment at par of loans issued at a discount, should be treated as additional interest on the loan, both for the payer and the recipient. That is what the decision in *Lewis v. Peter Dixon and Son Limited*, 25 T.C. 353, is contrary to the commercial understanding of such arrangements.

The witnesses have submitted to the Milford Tucker Committee on the Definition of Taxable Business Income

that premiums on the repayment of loans and discounts on the issue of loans are business expenses because they are similar to the interest cost of borrowing money. It would logically follow that they should be regarded as income of the recipients, thus overriding the decision in *Lewis v. Peter Dixon and Son Limited*, 25 T.C. 353.

The Milford Tucker report did not accept the submission on behalf of business borrowers and if the Royal Commission agrees with the Committee on this point it would be logical to treat the recipient of premiums and discounts as having received an accretion of capital, tax on which had been paid by the borrower.

Existing loans on these terms have been arranged with the present tax situation in mind, and to alter the tax treatment of discounts and premiums may involve some transitional arrangements.

In a survey of the definition of taxable income, it is proper to recall that the main commercial purpose of discounts and premiums on loans is to shade the yield of interest more finely than is convenient to express it in the rate itself. If the Commission should decide to recommend an alteration of the present tax treatment, the alteration would be expected to affect both the borrower and the lender.

Foreign Exchange Profits or Losses

15. Realised profits and losses on foreign currency, balances and claims arising from trading should be included in computing business income. The decision in *McIntyre v. H. T. Jenkins and Sons Limited*, 10 T.C. 372, was based on a too narrow definition of business profits. Just as the witnesses object to a narrow definition of expenditure made for the purposes of the trade, they admit a wider conception of profits made in the course of trade.

Transfers of Property

16. The main topic of discussion arises from surpluses on transfers of property which now are excluded from the concept of income. They have been given the misleading description of "capital gains" which is ambiguous. It can mean gains arising from transactions with capital or, alternatively, gains of any description which are now treated as capital for Income Tax purposes. Both meanings beg the question by calling the surpluses "gains".

17. Property is a very wide term. It is necessary to analyse it into types of transactions or possibly types of property before any reasonable deduction can be drawn that the result of the transaction either is or is not now included in income and that some transactions now excluded should be included. American precedents are of little use because of the different structure of their tax law. For example, in the United States company profits are taxed in the hands of the company and dividends out of those taxed profits are again taxed in the hands of shareholders as a separate fresh source of income. In the United Kingdom, the Income Tax paid by the company is treated as having franked the dividends received by the shareholders for the standard rate of tax.

Personal Effects and Dwelling Houses

18. In the first place it is proper to dismiss the possibility or desirability of taxing surpluses on transfers of personal property, by which expression is meant goods acquired for personal use, amenity, or enjoyment, which are not acquired for the purpose of resale. It includes furniture, jewellery, private cars, works of art, and apparel. It also includes a house acquired for occupation by the owner or his dependents.

For one thing it is impossible to discover or to check such transfers. Moreover to tax surpluses should involve the allowance of losses, and losses include destruction and scrapping through age as well as losses on sale, and to admit them is to admit personal domestic expenditure as a deduction from taxable income.

Gambling

19. The second exclusion would be surpluses arising from bets, football pools, and other wagers, whether legal or illegal, unless the practice or betting is a profession. There are more losses than surpluses because the organisers or stake-holders and the Betting Duty and Pools Duty take part of the stakes and leave only a balance for prizes. This type of surplus is already taxed by other forms of taxation.

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[Continued]

Sales of Property between persons not engaged in business

20. The third type of exclusion concerns transfers of income-producing assets between persons not engaged in trade. This can be a very wide class but the principle seems to be the same for the different types of assets.

The purchase and sale of shares, stocks, and bonds can be analysed for the purpose of seeing whether there is a ground for extending the present concept of income.

Persons buy investments normally in order to get an income from their savings. They sell them either because they have to dis-avow, that is, to realise capital, in order to meet current expenses, or to change the investment in order to improve the yield or to avoid an expected reduction in yield.

The fluctuations in value can arise from the following causes:—

- (a) An excess of buyers over sellers causes the market price to rise and the reverse causes a fall.
- (b) An increase in expected dividends will cause the shares to rise, a decrease causes them to fall.
- (c) An increase in retained profits of a company increases the expectation of future dividends and causes shares to rise in value.
- (d) A general rise in interest rate will reduce the capital value of shares, a general fall in interest rate causes the capital value to rise.
- (e) A fall in the value of money causes equity stocks to rise whilst fixed interest stocks remain constant in capital value expressed in depreciated money.

As regards (a) the effect of demand and supply must produce more losses than profits in the aggregate, because the brokers and jobbers take their remuneration for services and the State levies a stamp duty.

As regards (b) and (c) the profits in question which cause the rise have themselves been fully taxed on the company. It seems to be unreasonable to suggest a further tax on a surplus on the sale of the capitalised value of those profits, and, consequently, to deduct a loss from taxable income.

So far as surpluses or deficits arise from a lowering or raising of the general rate of interest, it is recalled that the Government control the rate of interest. It would be an odd result of a decision to alter the rate of interest on general financial grounds if a tax on surpluses on investment transfers followed a reduction of the rate and a rebate of tax on losses followed an increase in the rate of interest.

As regards (e) it would be unjust to tax the purely inflationary rise in value of equity shares. Such a rise is not income; it is merely a preservation of capital which looks like an increase in wealth because other forms of capital shrink in value. Correspondingly, an apparent fall in value during deflation is not a loss which should be allowed against taxable income.

It is relatively easy to turn a fall in value of shares into a realised loss, at a moment when it suits the taxpayer, by selling his shares and by buying shares of a similar class which are bound to be equally depressed. He can then wait until the market rises, having cashed in his tax rebate. It is more difficult to dispose of a valuable share without incurring the tax liability on the gain, but the taxpayer with a fluctuating income can choose his moment to take the gain and to establish a new cost for the switch investment in readiness for the next drop in value.

21. The same objections appear to be valid for any kind of investment which is transferred between persons who are not engaged in business. The graphic case is that of the owner-occupier of a house. If he owned a house purchased in 1939 for £1,000, the general fall in the value of money and shortage of houses with vacant possession will have created a rise in market to say £3,500. So long as he continues to live in it no surplus arises. If the circumstances of his livelihood cause him to move to another town he would have to sell the house and realise a so-called surplus of £2,500. But he would require all

the sale proceeds and more to buy another house in the town to which he removed, owing to legal expenses, stamps and removal costs. In the end he would have a house no better than his previous house and would have lost the removal costs. If there were a tax on surpluses he would be liable for tax on £2,500.

It is the same with other types of savings. So long as the taxpayer does not change the form of his savings, there would be no liability. If he ventures to change the form of his savings a liability would arise.

A tax on surpluses and a rebate on losses could only be applied at the time when the surpluses or losses were realised by an actual sale. It is impossible to follow the unrealised rises and falls in value whilst the investment remains in the same ownership. A tax would seriously distort the normal flow of investment and frustrate the main purpose of investment markets to determine price if large volumes of purchases or sales were made for personal tax reasons. It has proved impossible in the United States to construct or to remedy the reaction of investment deals which were organised mainly in order to economise on taxes.

Transfers where one party is in business and the other is not

22. Following the classification of transactions by reference to the circumstances that the persons concerned are or are not in business, the next class of transactions appears to be those where one person is in business and the other is not. We would equally rule out this class were it not for claims which we have made for business to write off the cost of acquiring the asset and were it not for the principle mentioned with caution in paragraph 145-6 of the Millard Tuckey Report and repeated in the discussion on Leasehold Property, paragraphs 225-7.

23. Where the buyer is in business and claims to amortise for tax purposes the cost of an asset purchased from a person who is not in business, the situation of the seller would normally be examined, primarily to ascertain if the transaction had been effected on an arm's length basis. Section 59 of the Income Tax Act, 1945 (Section 327, Income Tax Act, 1952) would cover this contingency.

Assuming the sale is at the full market price of the asset, the seller who is not in business should not be in any different position for having sold to a business buyer than if he had sold to a private person who was not in business. Any surplus or deficit he may realise as changing his investment should not be recognised for tax purposes for the reasons mentioned in paragraph 20.

Premiums for Leasehold

24. We have dealt with the consideration paid for a long or short lease of a building by abandoning the attempt to shift the incidence of the tax from the lessee to the lessor on condition that the lessor should not include the receipt in his income.

Purchase of Natural Resources

25. Consideration paid for the licence to use natural resources is different from a premium paid for the possession of leasehold land, because the natural resources are used up and nothing useful is left behind after the resources are worked out. The operator in effect buys the natural resources and consumes them in his business. He should have the cost allowed as a charge.

But when one comes to consider the situation of the seller of the natural resources the same type of difficulties arise as in the case of leasehold premises. The seller has sold a potential source of income. He had the choice of receiving royalties which are taxable on him and allowable to the seller, or of selling the right to consume the natural resources for a capital sum. Whether the land without its natural resources is included or excluded from the sale does not affect the problem. If the operator can write off the capital sum as he uses the natural resources, should the seller be charged on an equivalent sum? One would have liked to have found an answer but in fact it is not necessary. The Town and Country Planning Act, 1947, has appropriated to the State the rights to work natural resources (except agriculture, forestry, and fisheries) in the United Kingdom, and there is no possibility of taxing an overseas seller.

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[Continued]

Transfers of Business

26. Transfers between persons who are in business include transfers of businesses and parts of businesses as well as transfers of assets with no goodwill attaching. The transfer of businesses and parts of businesses can be analysed into consideration paid for goodwill and consideration paid for assets. Broken up in this way, transfers of businesses differ only from transfers of assets in the addition of a figure for goodwill. Transfers of assets involve balancing allowances and charges which are a separate subject considered below. As regards goodwill, it would be better not to include surpluses in income or to deduct losses from income. Goodwill is an intangible expectation of profits. It is difficult to value created goodwill and there is little logic in dealing with purchased goodwill in one manner and in created goodwill in another. It would be almost impossible effectively to allow the loss of goodwill because the trading losses which caused it would leave no profits against which it could be allowed and, by the time profits began to be earned again, the goodwill would be returning.

Balancing Charges

27. As regards transfers of assets out of a business the machinery of balancing allowances and charges deals with the subject except in one respect. The balancing charges are limited to the allowances previously given. Leaving aside for the moment the complications of inflation, this limitation causes a loss of tax in the case of a sale of secondhand machinery at a price which exceeds first cost. The buyer can write off his cost but the seller is not charged on his profit. There is not now the same loss for buildings because the allowances are limited to the first cost of erection. But the witnesses have asked that the allowances should be based on the cost to the present owner. They have also asked for the same treatment to be given for non-industrial buildings.

EXAMINATION OF WITNESSES

4216. *Chairman:* Mr. Bower and Mr. Lixton, you gave evidence at an earlier time on the question of replacement cost, and we are grateful to you for the very full memorandum which you have let the members of the Commission have on this particular subject. You will appreciate that, by this time, the Commission have heard a great deal of argument on the very difficult question of replacement cost, and you have put your point of view, if I may say so, very fully and very clearly; so if we do not exhaust you with questions about the points which you raise, it is because they are very clearly in the minds of the members of the Commission already. Your document I think was put in some time ago, some months ago. Is there anything apart from the further document you have given us dealing with the Board's memorandum* that you would care to add in general?—*Mr. Bower:* No, Sir. Our thought has developed since January when we were rather talking of finding the replacement cost as the co-efficient with which to write up the depreciation charge, but on further thought it seems better to adopt a general price index rather than to try to find what may be the particular replacement cost of a particular asset. All we are trying to squeeze out is the fall in the value of money, and the general price index seems to be the better instrument with which to do that rather than any particular index for any particular asset in any particular business. Also it has the advantage of simplifying it very considerably because that is a co-efficient which is for everybody objectively fixed, and all that remains is the arithmetic.

4217. Of course, the earlier system of an index standard for each asset would lead to a great deal of additional administrative complication?—*Yes, besides being unreliable.*

4218. But I would like to ask you really one or two quite general questions on this subject. It is your theme that in times when the purchasing value of the £ alters materially the old conception of business profits is inappropriate?—*Yes.*

4219. I follow the argument, but how far do you go in applying that principle, because we are dealing with it only as a principle which you say ought to be adopted

Therefore it is logical to concede that the seller should include in his income the excess of the sale price of depreciable business assets after revaluing his first cost in old pounds to pounds current at the date of sale.

Corporate Distributions

28. One final class of surplus needs to be examined, namely surpluses arising to shareholders on distributions by a corporate body otherwise than by way of dividend.

Stock Dividends

29. The law on bonus shares is accepted as regards shares of the same class or shares of a different class, but a distribution of bonus debentures should be treated as a distribution of cash net of tax.

Surpluses on Liquidation

30. At present there is no tax charge on the surplus—nor any allowance for a deficit—on liquidation of a company after settling arrears of unpaid taxes, except the distribution charge for Profits Tax at varying rates according to the year of retention of the profit from distribution. This distribution charge in respect of profits retained between 1st January, 1947, and 31st December, 1951, has been reduced to a net rate of Profits Tax after Income Tax by the Finance Act, 1952. The better course, however, is to cancel the distribution charge which arises solely by reason of liquidation of the company.

The general principle of treating distributions on liquidation as capital seems to be sound in view of the fact that the profits during the life of the company have been subjected to Income Tax, Profits Tax, and Excess Profits Tax or Excess Profits Levy. The corporate taxes make up for any possible loss of Surplus due to non-distribution, whereas the Revenue have gained by not having to meet claims for repayment of standard rate Income Tax by those who are not liable to pay it.

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for the purposes of taxation? If it is the right theory, the one you advocate, it cannot stop there, can it?—*We really ought to say it should not begin there. It should begin in the practice of accounting and taxation should follow what is a general business practice in that respect. When you say how far do you take it, do you mean in respect of the assets or liabilities?*

4220. No, I did not mean that. I meant if the theory you put forward is the right principle, then it ought to be adopted for the ascertainment of business profits generally.—*Yes.*

4221. Could you say that it is today?—*No, those people whose attention has been drawn to it are certainly making such provision as they can, or as they know how, with the advice of their auditors, but one could not say that over the broad run of industry the majority are adopting this theory. They are rather setting aside general reserves without particular earmarking.*

4222. It would enter also into the question of the prices which a business would be entitled to charge for its products?—*That is the beginning of things I would say. If the price policy is not right the profits are not there with which to make any adjustment.*

4223. Do you think today that it is widely adopted as a measure of . . . —*Price policy?*

4224. Yes.—*Yes, except where competition happens to be very severe, or where businesses are pinned down by price limitation or some other form of price control by a Government Department.*

4225. It would come into consideration, I suppose, of wage negotiations too?—*Certainly.*

4226. To what extent, as you have wide experience of these things, does it come in today?—*Into wage discussions?*

4227. Yes.—*I could not say. I have not got wide experience of wage discussions.*

4228. I was thinking of your Association generally.—*Yes.*

4229. That is what was troubling me really as a general principle, that, in a sense, of course, taxation might lead the way, but it does involve the general question of

* Not reproduced with these Minutes of Evidence.

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[Continued]

accounting and many other very wide considerations affecting social life as well.—Yes, that is the strongest reason why it should be adopted. Taxation comes second, although taxation may have been the spur or the goad which has started the enquiry or has directed attention to it. The damage caused by taxes has shown that there is something seriously wrong with the methods of calculating profits, and it has led up to an investigation of accounting principles.

4230. There is another general question I want you to enlarge upon for my help. There is implicit in this theory the idea that the business ought to be allowed to maintain a constant volume of trade, as it were, out of tax-free resources. I think I am making it clear?—Yes.

4231. But I have thought, in approaching this matter, that businesses expanded and contracted their volume according to economic circumstances?—Yes.

4232. Conditions of trade?—Yes.

4233. Among other things their own financial position?—Yes.

4234. What is the standard that shows what volume of business ought to be credited to be maintained?—I agree that the point is difficult. It really means trying to define what is the normal productive capacity, which involves saying what is the normal means of producing things, and what is the normal stock that one would carry, and since one is dealing with something indefinite the only thing you could start with was the volume of productive capacity at the moment you started following current costs.

4235. I follow that. It is not any good looking back at a pre-war year, is it, and saying, even if you could find a way of eliminating the problem of new businesses, that is the normal standard?—No, because the pattern has changed since pre-war, and it is hopeless to try to make any retrospective tax adjustment pre-war, the cost would be terrific, about £3,000 million, but the point will arise if one were to adopt this idea of making tax-free reserves as to what should happen at the end of the business. If then on the theory of equality of misery, because the bondholder has lost part of his capital therefore the equity holder ought also to lose an equal part of his capital, then there might come a question as to what should happen at the end of the business. In that context one would have to reflect that the business has suffered by conventional accounting on a triple rise in prices since the war, and has also borne special taxes which have been levied only on equity holders. The criterion of pre-war would only be a starting point from which an attempt would have to be made to measure what was just between bond holders and equity holders when you came to reckon up what should happen at the end of the business. During the life of the business to our mind there is no question whatever that the business must be able to renew itself out of its sales proceeds before there can be any talk of a surplus for any purpose whatsoever.

4236. One way in which the problem you are presenting strikes me, I will see if you agree with this way of putting it, is that when you have a marked depreciation in the purchasing power of the £, even without the incidence of heavy taxation, you are bound to need a good deal more money to sustain the volume of your business?—Yes.

4237. Is not the real problem, out of what resources is that money to come?—Yes.

4238. It is inherent I think in your way of putting it that those resources ought to come out of the...—Customer.

4239. No, out of the tax-free accounts of the business, I will not say profits.—Yes, primarily.

4240. Supposing somebody said that if you need more money capital in the period of inflation why should you not go and get it, either from the public or from people who have got money which they can lend or temporarily from banks? What is the answer to that as an alternative proposition?—It is asking a business to sacrifice that amount of its capital by a bad price policy or tax policy, and then borrow from other people in order to make good that loss. If that was so it would be against the main principle that the business ought to be able to renew itself out of its sales proceedings. It should not need to go outside except for extension.

4241. Even in a period when owing to the depreciation of the £ a great deal more money is needed to sustain the volume?—Yes, that is right.

4242. I am asking you that, because, if you look at I think it is paragraph 34 of your first memorandum, you say at the opening of that paragraph something that we have been trying to get more closely to grips with in recent months: "The widespread shortage of finance which business is experiencing". I was wondering out of what material you could demonstrate the statement that there is today in business, a widespread shortage of finance?—We have not tried to work it out statistically, although it could be worked out statistically. There is an impression amongst our members that they are short of money. This year owing to the shortage of credit there has been a shrinking of stocks which has cost the need for more money, but that has not gone far enough, and traders are going to the banks in the first place, and if they cannot get money from the banks they try to get it from the wholesalers, the wholesalers try and get it from the manufacturers who in turn get it from the bank, in other words push the credit back up the line. Those who can go into the money market of course go into the money market, but it may be that the Central Statistical Office could answer your question more accurately than we can. In the provisional figures of national income for 1951 on Table 6....

4243. Could you give me the reference to the paper?—Cmd. 6486, Table 6, combined capital account, you will see on the right-hand side, the gross domestic capital formation (figure stock appreciation) is £2,440 million by persons and corporate bodies. If you look down the left-hand side you will see what provision has been made against it. One can only add up £2,277 million which on those figures for 1951 shows a shortage of about £163 million, and that feature is apparent through each of these four years shown on the Table. That money must have come from outside sources and not businesses. The bulk of it is out of Government surplus and out of overseas money.

4244. When you say a shortage of finance do you mean difficulty in obtaining it either from internal resources or external resources?—The need to get it rather than the difficulty.

4245. I wanted to ask you a question about the system of initial allowances, because I think I have gathered from your answers on the earlier day, and what you say in paragraph 24, that you do not regard them as in any way a satisfactory solution to this problem?—No.

4246. But they can be at any rate a help, would you go that far?—Temporarily.

4247. That is, described as a temporary loan?—Yes.

4248. You say there "... the objectionable feature of selection between industries is deleted." Those are the opening few lines of your paragraph 24.—Yes.

4249. I would just like you to enlarge that for me, I know that there have been criticisms of the proposal that if you restore initial allowances there should be some means of discriminating between various industries, but what do you regard as the inherent objection to a proposal that there should be discrimination?—The inability to discriminate. I mean what criterion can one adopt? If you say the making of toys is quite useless, why should that be stimulated, on the other hand it might be an excellent export in competition with German toys which used to be sold pre-war. That is an example, but it would run through all the various industries, and nobody can say which is the winner of the future.

4250. But if you are approaching this from the point of view that it is greatly in the public interest that some assistance should be given to this problem of finding the money for new assets, it is not impossible for Governments to distinguish between the importance in the national economy of one industry rather than another, is it?—Yes.

4251. It must have been done frequently in the past in one form or another?—Yes.

4252. Why should it be impossible in this connection?—I should say taxation is not the right instrument to use, it is a bad instrument. It is capricious in its incidence. It does not happen at all if there are no profits, and the ordinary price mechanism is the best way to deal with it.

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4253. You are familiar with the present income tax structure with all its ramifications, but they do include even today, do they not, in the tax system a variety of distinctions between the claims for the purposes of taxation of different industries, different activities?—No. Mining has special allowances which other industries have not got; agricultural development has several allowances on its own account, but it is only in the method in which the allowance is given which distinguishes it. Commercial buildings have no depreciation allowance which we say is a blot on the system which ought not to exist, but apart from that there is not a great deal of discrimination.

4254. That is the sort of thing I was thinking about, and when you come to calculating the rate of allowance for plant and machinery.—Yes.

4255. The assets of one industry may be at a different rate from the assets of another.—That is not by reference to industry, that is by reference to the life of the assets.

4256. I suppose one industry uses one kind of asset and another industry uses another, by and large?—Yes.

4257. Do you think that discrimination of this kind is inappropriate in a taxation system?—Yes, I think it is unfair, and it depends on somebody's judgment which some time or other is bound to be wrong.

4258. Would you just tell me, I have not followed your statement: "Initial allowances are not appropriate for buildings." What have you got in mind there?—This was a recommendation of the Milford Tucker Committee that initial allowances should be given for plant, and they made no similar recommendation for buildings, if I am right.

4259. Yes, I see.—I am merely reporting what was said in paragraph 126 of the Tucker Report.

4260. Supposing that at some stage the system of initial allowances was restored, have you considered whether you think, in general, the rate allowed ought to be flexible according to the economic situation of the country, or whether it ought to be unchanged year by year as is sometimes advocated for taxation measures?—If you admit initial allowances are a desirable thing.

4261. I was assuming that.—Which we do not, then it would be better for that to fluctuate according to the degree of inflation, because that is the purpose for which they are put forward. It would follow that if inflation were 200 per cent. the initial allowance is so much, and if it were 300 per cent. it should be so much more, and it brings you down to the logical end if inflation were 1,000 times you write off the whole of the asset.

4262. Because if you make them flexible so as to give the Government better control of the economic situation, I suppose it is an upsetting element in calculations of the industrial user, is it?—The industrialist can only use that initial allowance for the purpose of his tax computation. He could not use it in his accounts for finance or for cost purposes. He has to state the profit for the year. The initial allowance is something which disturbs the profit for the year.

4263. He may be making out a constructional programme over a period of years on the assumption that a certain amount of profit, if he makes it, will be freed by initial allowance, and then find the rate has been altered.—Yes, but I do not think that he would use the initial allowance for calculations of profit. It is merely a cash deduction as to how much money he was going to pay out and how much money he was going to receive.

4264. Have you considered a proposal which we have had put before us that when businesses have depreciation allowances, initial or otherwise, which the profits of the current year have not absorbed they should be allowed to call in aid tax profits of past years to absorb them and claim tax back on those profits?—No, it is one form of claiming to carry losses back. Since we do not like initial allowances we have not considered the implications of what would happen if we had them.

4265. It could arise even if you did not have initial allowances?—On trading loss.

4266. On the statutory depreciation?—Yes.

4267. I have one more question on this difficult subject. With regard to your Answer A, it is a question I think you anticipated before, and I am not clear why

you are maintaining there in paragraph 1 that, if you are going to measure the profits of business by allowing for depreciation of the purchasing power of the £, you should not carry out that analysis with regard to your liabilities as well which, by this argument, you are meeting in the depreciated £.—Yes.

4268. That is excluding trade creditors for money, though they seem to me to be rather the same point; you reject loan capital and fixed preference shares as being matters for adjustment. But if you eliminate the question of whether the holder of the loan capital has got, as it were, a civil right to be paid more, it is still true, is it not, that the business which borrowed its £s in the earlier year and promises to pay so many £s a year on it is meeting that obligation in depreciated £s?—Yes, it is true. In a time of rising prices the equity holder benefits at the cost of the bond holder, if I may use that expression for the long term creditor, and when prices fall the bond holder makes a profit at the expense of the equity holder. They are two entirely different kinds of property, each carries its own risk, in own terms, and the parties make their bargains with their eyes open. If there is power in the document to vary the terms, such as a gold clause or a dollar clause, or a clause allowing for variation on the capital or the interest by reference to any other index than the current money, it would follow that that would be observed in the same way. Put it this way, Mr. Chairman, we are talking in terms of tax and tax adjustments, and that is the topic on which one addresses the Commission, but if there were any question of reviving the rights of parties to a contract for a preference share holder against an ordinary share holder or a debenture holder against another share holder or a creditor against a debtor, that is not primarily a tax matter. It is a matter of adjusting the terms of their own contract. If it were possible to allege that circumstances had so changed that the terms of the contract had become frustrated or entirely different from the intent of the party when they started, that might be a matter which could be done under common law and tax would follow the consequences of that. It seems rather putting the cart before the horse to postulate that something should happen in tax matters which has not happened between the parties themselves.

4269. I follow all that, I think. I really was not thinking of the respective equity position of the ordinary share holder on the one hand, and the money creditor on the other hand; I was really thinking of the right method of drawing out the account in any one year of the business itself because that is the basis of the tax claim, is it not?—Yes.

4270. And your theme is that, so far as charges like depreciation go, you ought to adjust because the £s which you are putting as your charge are not the £s which you bought the fixed asset with?—Yes.

4271. But still considering only what adjustments are needed for that reason in the accounts of a business, I was very impressed by the view that it was getting a benefit on the other hand in paying its liability for the year in equally depreciated £s and I was not clear why your arguments, about the civil rights of the parties, really dealt with that point?—They do not deal with that point. In talking purely on tax adjustment we drew the distinction between what one might call real assets such as goods and capital equipment and claims for money on the other hand. So long as the long term creditor has a claim for money and only for money, logically it follows that it will be dealt with in terms of money and that seems to be the only possible distinction one can make.

4272. One question about the subject of capital gains which is dealt with in your other document. Again this is a subject we have heard the arguments for and against at some length and I would like to be clear as to your approach to this matter. I think your approach is this, is it not? You say that according to your understanding of the task that has been set us we are not really asked to consider whether there should be a capital gains tax itself?—No.

4273. But whether there are what are called capital gains which ought to be considered income for the purposes of income tax?—Yes, we rather took the increments

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with the Income Tax Act as it is now with its five schedules and tried to examine if there is anything which escapes the net which ought to be brought into the net.

4274. Then you pass on to point out that a tax of this sort is part of the United States system, and your general comment on that, I do not know how much detailed experience you have got of it, is that it has been rather an uncertain tax in the United States and in its form it has been changed from time to time ever since it was instituted. Have you got much experience of its working, because we would be interested to know?—Not of this. We know it is a nuisance, and we know from our own experience that businesses which are liable to a rate of tax of, say, 50 per cent. are delighted if they can take a piece of their profit and say, "This is a capital gain" and pay 25 per cent. on it. It is rather working against the Revenue because of this special rate for a capital gain. That is one instance of the difficulties.

4275. It may suit a business that a particular transaction is a capital gain?—Yes, instead of an ordinary profit.

4276. There is one further reference in paragraph 21 to the United States, and I would like to know how much you have got behind what you say. At the end of the paragraph you say:—

"It has proved impossible in the United States to contract or to remedy the reactions of investment deals which were organised mainly in order to economise on taxes."

That is the idea that it has a disturbing effect on the market for securities?—The Stock Exchange market. In the months January, February and March taxpayers who are concerned in this are looking down their portfolio of investments to get ready for 31st March.

4277. Has it been found to make any sizeable contribution to disturbed market conditions?—I could not answer that. There are so many things which affect the American Stock Market that it would be very difficult to isolate this particular one and say it has this effect.

4278. That is what struck me. We heard about it before from some other witnesses as being a point, but it is difficult to isolate it as a factor.—One can only assume that if there are selective sellers, put it that way, in the months from January to March it would have its effect on the market. It must have some effect although one cannot probably trace the end of it.

4279. I wanted to ask you one question about your views on stock dividends, paragraph 29. It is all within your capital gains chapter.—Yes.

4280. You say:—

"The law on bonus shares is accepted as regards shares of the same class or shares of a different class, but a distribution of bonus debentures should be treated as a distribution of cash net of tax."

I do not know how much people do use debentures for bonus distributions nowadays, but I am not quite clear why you make the distinction if you accept the view that bonus shares themselves, of the same or a different class, are not equivalent to income.—The shareholder, as you said previously, is quite a different person from a debenture holder, and by taking a piece of his capital out of the company and creating himself a creditor to that extent, he has altered his status to the extent of the amount of the transfer of property. How can I express it?

4281. I quite follow.—That debenture holder no longer shares in the fortunes of the business. He is not a member of the club to the extent of that debenture. He is an outside creditor, and he has a claim on the club to the extent of that debenture. That seems to be quite a different thing from altering the piece of paper which he had in the form of a share certificate, instead of writing one share, writing two shares.

4282. To the extent that he has created a debenture out of hitherto unappropriated profits, is he not, to that extent, depreciating the value of his existing share?—Yes, he is, but it is more in the nature that the company has made a special distribution to the shareholder and he has lent it back, not paid it back, lent it back to the company on promise to repay him. It is more in the character of an actual distribution of wealth so far as the company is concerned than a mere adjustment of the shareholders' rights.

4283. You agree that even when the company does that, which gives him obviously a useful piece of property, a debenture, it does depreciate the value of his existing share to that extent?—Sure, but so would a dividend.

4284. Mr. Kaldor: Mr. Bower, I have been over this ground of replacement cost I believe with you before. Reading your recent documents, I would like to ask the one question which I am not quite clear about. Is the major reason for your advocacy of this reform one of equity or the bad economic consequences of the present system?—It is difficult to say which is predominant. We start off with the question of tax in the first place, but then when you come to consider what is happening I think social consequences are the most serious of all the problems at the moment, because to report profits on the conventional basis misleads people and leads to wrong judgments. With the present state of the country, when we are balanced on a knife edge, a wrong judgment can be extremely serious.

4285. You mean that the present system of accounting over-states profits?—Over-states profits with rising prices and under-states them when prices fall. I should put that first of all.

4286. What is the bad consequence of that socially?—It creates a spirit of boom and leads to an over-estimate of a desire, to expand businesses and to invest and put too high a pressure on investment resources, and produces or assists inflation from which it has arisen. That is probably the worst one, and the next one is that it can lead to distributions of capital in the form of income between shareholders and the company, and on wage matters naturally trade unions when conventional profits run on a very high level they say, "We want a share in these high profits", and it can so add inflation by putting up wage costs and adding to it. Those are the three things I can think of at the moment, leaving tax aside.

4287. You would say that calculating profits on a historical cost shows profits so large that business men are themselves deceived by it?—Yes.

4288. And therefore they try to expand their business too much?—Yes.

4289. And they pay out too much in dividends?—They cannot do both, obviously, either one or the other.

4290. Now should the first remedy for this particular problem be to get business men to adopt a different system of accountancy quite irrespective of taxation?—Yes, that is a desirable thing which ought to be adopted, but whether it should precede adjustments of taxation rules, I do not think it should. For instance, the Royal Commission is sitting now, and one would like a decision within five years, whereas it would probably take five years or more before businesses would generally adopt the idea of cost accounting.

4291. What would happen, for example, if for taxation purposes we adopted this system which you advocate, whereas businesses for accounting purposes continued to adopt the existing system?—It is hypothetical, but I think that they would very readily turn on to current cost accounting if it were recognised for tax purposes.

4292. If they did not, would not that mean not only would they over-state their profit...—And the result would be bad.

4293. In addition they would be relieved of tax in times of rising prices and they would have more money to distribute, and more money to invest, in times of inflation.—They would not be acting in good faith, would they, when it has been brought home to them by the fact that the taxation is altered that their basis of computation is wrong; they would be little less than honest if they said, "It is a tax relief, but we are not going to adopt that idea in our accounts."

4294. There are many companies which have adopted the system of making great and specific reserves for the extent of replacement costs on fixed assets, and also stock reserves. Do you not think, as far as the behaviour of business is concerned (that is to say, that they become over-optimistic in times of boom and think their profits are higher than they really are, and therefore either spend too much on new capital outlay or pay too high dividends) that problem is not adequately met by this practice of showing in their accounts presented to shareholders the

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specific reserves needed for this purpose?—Adequately met from what point of view, from the point of view of their business policy or taxation?

4295. From their business policy, that is what we are considering now.—I should say not. It is just described as a general reserve and is looked upon as a reserve of profit, whereas if it were not looked upon as a reserve of profit which can be drawn on in case of need, there would be more conservatism and less optimism. You have gone on the assumption that the business man is misled by his accounts.

4296. That was your assumption.—Therefore if he is misled by his accounts he has got to be as optimistic as ever he was before.

4297. It makes all that difference whether these sums are shown as provisions, which are charged before getting at the profits, or reserves which are appropriated out of profits?—It shows that the business man who is conducting that business understands what he is doing. If it were a price difference reserve or capital reserve he would know that in no circumstances was it available for distribution, it is part and parcel of the money subscribed for share capital, and cannot be touched except if prices fall. Apart from that it is unobtainable.

4298. I take it that your major point is that it is over-statement of prices in times of boom due to these factors, and is under-statement in times of depression and that is a bad thing?—Yes.

4299. Because it leads to too much optimism in the one case and too much pessimism in the other?—Yes.

4300. I see that, but, at the same time, the fact that in times of boom the system leads the tax authorities to draw more money out of businesses, and in times of depression it leads them to draw less money out of businesses should work in the other direction?—I do not get your starting point.

4301. There are two points here, are there not? The point which you stated that in times of inflation or boom profits appear. . . —High.

4302. Too high?—Yes.

4303. And therefore business men or shareholders, whoever is responsible for decisions in a business, are too optimistic?—Yes.

4304. They either make too many plans for expansion, or they distribute too much money for shareholders and the contrary in times of depression and falling prices. At the same time the present system of taxation, just because it operates on historical costs, tends to take more money out of businesses in times of boom, does it not?—Yes.

4305. And less money in times of depression?—Yes.

4306. If we adopted this reform which you advocate the fact would be that tax liability would go down in times of boom and it would go up in times of depression?—Yes.

4307. What I am asking you then is this, from the point of view of getting the . . . —Country.

4308. And getting business men to behave in the right sort of way, is it a good thing or a bad thing that in times when people are too optimistic they should be deprived of money by means of additional taxes, and in times when they are pessimistic they should be given more money because they have so much less taxes to pay. Does it not work in the other direction?—It is faulty in different respects. It comes at least a year late owing to the taxation of profits on the preceding year, and sometimes almost two years late, and also on your suggestion what is happening is that the savings which the business ought to make the Government is making itself, and it is giving back money or reducing its claims when a depression comes, whereas the system of current cost accounting would enable the business itself to do the saving, and it would not need to be a charge on the Government. There are two kinds of savings.

4309. In times of inflation business men are optimistic and what restrains them are the liquid resources. If there are more liquid resources there would be less restraint.—No, the thing works two ways, they would have more power to extend their investment, but have less desire to.

4310. Because they adopted a different system of accounting?—Yes.

4311. But is not that argument in favour of the view that what is needed more, in your view, is a change in the system of accounting rather than a change in the basis of taxation?—The two things go together except in time. I have already said that it would be desirable for businesses to adopt this system of accounting generally, but whether a business adopts it or not I say that the tax effects following that accounting are bad.

4312. So far as the tax effects are concerned you cast for the moment separate these two things, namely, the aspect of over-statement of profits and accounts, and the aspect of fluctuation in the tax charge?—Yes.

4313. That is, mentally separate these two things, and you would agree that the fact that the tax charge fluctuates in this way is on the whole a good thing?—No, I would not say that. I think what you are probably thinking about is the desire to check consumption or excessive capital expenditure in time of boom. I think it would come timely at the moment. The first thing is that if the prices movement is moving up and down, down as well as up, your taxes come much too late, because they are not levied at the same time as the profits are made. For the profits of 1951 the tax on them is paid in 1953.

4314. You said that before, but is it not true that businesses have to make provisions for the payment of taxes immediately?—They do not have to, but if prudent they do. The provision does not take any money out, and your point is that the money goes out. I would say that the money goes out two years too late, and therefore in time it is wrong.

4315. There is one more point I want to ask you. Your Association's objection to the system of initial allowances is chiefly that it is merely a temporary loan which has to be repaid?—To our mind it hinders the trade. It does not answer the problem, it leaves the problem untouched. In other words we have described it as a red herring which has confused opinion for the last four years.

4316. Is not the question really what it is you want? If what you want is what you call a correct statement of profit in accordance with current costs, then surely nothing but a reform of accounting can do that; you want businesses to change their system of accounting?—Yes.

4317. That is your main purpose; the other is to maintain capital intact?—Yes.

4318. Are you not confusing these two different points of view?—No, they go together. It is rather saying that a business could maintain its own capital intact if it kept its accounts right, and it could not possibly go wrong.

4319. Initial allowances make it possible for people actually to incur capital expenditure and replace capital assets they would not have been able to incur otherwise; does that not help?—A very slight help, only a slight help. They are a help at the moment of investment but thereafter they have to be paid for by reduced allowances for future years.

4320. This is a question which interests me, because you say somewhere in the document, I am not sure that I can find it at the moment, that the main reason for this claim on the replacement cost is the continuing nature of the business?—Yes.

4321. That the business is a going concern and that it ought to maintain itself indefinitely?—Yes.

4322. If you look upon the problem in this sort of way, the continuing nature of the business, does it not follow that the system of new allowances is not merely a temporary loan, but a permanent loan so to speak?—If you assume that replacements are to continue for ever and that they happen year by year and preserve the regularity.

4323. Whether it is regular or irregular is there not an assumption that replacements will continue to happen and are necessarily involved in the whole conception of the business being a continuing entity?—Yes.

4324. Which undoubtedly is a necessary part of the case for this replacement cost account?—Yes.

4325. If you look upon it in this way, surely a system of initial allowances, if maintained, is not a temporary loan, but it is a permanent change in the tax charge?—Yes, but compared with the system of current cost accounting it is inferior.

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4326. Because it does not adjust the amount of profits shown, is that it?—Yes, and it does not deal with the last asset or the first asset whichever end of the chain you like to take. One asset is left out.

4327. We need not bother too much about that.—And in the firing too, because your initial allowance which really enables you to deal with your second asset comes at the end of the first asset, so in point of time it is late.

4328. Why does it come at the second investment?—We have got the first investment now.

4329. I see what you mean. What you mean is that the introduction of a system of initial allowances . . . should start at the same time as the business starts, otherwise if you bring it in while the business is in being you ignore all the existing things which it has.

4330. New investment and not existing investment?—That is right, yes.

4331. As far as the economic effects are concerned, and distinct from any equitable effects, it is only new investments. If we are worrying about the problem from the point of view of retaining real capital intact surely all that is relevant is new investment, to give relief on new capital expenditure, not on old capital expenditure?—No, that is rather using income taxation as an economic instrument, I am not talking about that. It might have a somewhat similar effect but with the faults which I mentioned of time, and the omission of one asset. As a system, current cost accounting is infinitely superior to initial allowances. I do not say that there is nothing in initial allowances if there is a continuing turning over of capital investments, but it does not answer the question of continued rising costs or the intermittent replacement of assets, and certainly it does nothing about stock.

4332. One final question. Prices have risen by two or three fold since the war. If we now make an adjustment for replacement costs there will be a considerable addition to that part of the annual receipts of companies which are not taxed; in other words the definition of profits on which taxes are levied becomes considerably narrower, does it not?—Yes.

4333. That will mean a loss of revenue?—Yes.

4334. Would you suggest that this loss of revenue should be made up by an increase in the rates of taxation on profits which are still subject to tax?—That is all a question for the Chancellor of the Exchequer, but at the present time people who have to maintain stocks and fixed assets are being over-taxed compared with the people who do not have to retain stocks or fixed assets. While they are in business and they have to carry them they are being terribly over-taxed compared with other people. If they are put on the same level as other people obviously there is a loss of revenue to the Exchequer. Whether it is made good by increasing the general rate of income tax, or by consumption taxes, or death duties or any other way would be for the Chancellor of the Exchequer to determine when he is drawing up his Budget calculating what the consequences are going to be. If you say one should find that out of the yield of direct taxes, the answer is to increase the rate of tax, to let it come out honestly.

4335. May I put this question slightly differently? Supposing we were to find that the cost of a reform of this character, this is a purely invented figure, I have not tried to work it out, and I suppose nobody has, is set at £200 million in tax revenue.—Yes.

4336. Now you say, and supposing I were to agree with you, that businesses at the moment are too heavily taxed?—Yes.

4337. Supposing the same £200 million could be given to businesses in the form of a reduction in the existing rates of taxation?—No, the incidence would still be wrong, that is the point I am trying to get at. Some trades do not have to keep stocks and big fixed assets: some trades, the tobacco trade or distillers' trade, are bound by the nature of their trade to keep very big stocks, and fixed assets may not be so material. Other trades have to carry very heavy fixed assets, engineering and shipbuilding, and those people are under this particular disadvantage that we are getting at now. Merchants are not. Merely to reduce the rate of tax for all businesses alike leaves that inequality against which we are complaining. First you have got to remove the inequality.

4338. You are saying that this reform you advocate would benefit businesses which carry heavy stocks or a large amount of fixed capital in relation to turnover more than an equivalent reduction in rates of taxation?—Yes.

4339. But now from a general equity point of view, is it not true to say that, in times of inflation, businesses do make a benefit out of inflation which varies with the extent of their stocks and fixed capital in relation to their turnover?—You say "make a benefit". Do you mean by selling at high prices or merely that the stock has increased in value?

4340. By selling at higher prices.—In time of boom obviously it is easier to sell than in time of depression, is that what you had in mind?

4341. What I am trying to say is this: supposing you take two businesses both of which were in existence before the war and one of them has very small capital requirements, it carries very little stock and it has not got much plant and equipment. The other business has those things. Supposing that prices of the products have increased the same way in both cases, its direct costs have increased in the same way and the physical volume of turnover remained unchanged or changed the same way is the two businesses. What I am asking you is, making these assumptions, if after so many years you look at the change in the net value of these two businesses, which do you think has gone up more?—One of your hypotheses is wrong, if I may say so. You said that the current costs of the two businesses, one with stocks and one without stocks, is the same and that could not possibly be on rising prices.

4342. I said prices of the things which they are buying, their wages have gone up in the same way.—Is what you are getting at the realisable value of their stocks and the fixed assets which by reason of rising prices have increased?

4343. I am saying that as a result of general inflation that business which had a lot of real assets, either in the form of stocks or in the form of fixed assets, has benefited in a way the other business has not. Supposing the other business had a larger amount of liquid resources in the form of cash or bank balance or outside investment.—The answer is that it does not benefit so long as it keeps in business.

4344. Surely relatively to the other?—No, because if the factory has gone up from £10,000 to £30,000 it cannot touch that value except at the price of going out of business. So long as it continues in business it must have a factory, whether the factory cost £10,000, £50,000 or £100,000 it still has one factory, and it cannot turn that thing into depreciated £s except at the cost of going out of business.

4345. Do you not think when you say that that you have to distinguish between the business as such and the owners of the business? I agree with you that the business as such cannot withdraw that £30,000 without liquidating the business, but the shareholder who owns the business can do so by selling.—Selling his shares, yes.

4346. As between these two sorts of shareholders, the one which benefited more was the one which suffered more on your method of thinking?—Are you not changing the topic? What we are trying to find is the taxable profit on a business as a going concern. If you want to switch the subject into taxing the shareholder on the difference between his purchasing price and the selling price that is another topic altogether.

4347. We are trying to find out, supposing one wished to make a tax concession to the business, which would be the most appropriate way of making a tax concession, and when I suggested to you that if you wished to reduce the tax by £200 million on businesses it would be better to reduce the rate of taxation, you said no that would be inaccurate.—Yes.

4348. Because it would affect other people the same way, whereas this reform that you advocate would affect the business which has stocks and fixed assets more than the others.—That is true.

4349. I am trying to say to you that this matter of equity could be looked upon in two ways.—As long as you change the subject you are talking about and . . .

4350. Chairman: I think you have made your point.

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[Continued]

4351. Mr. Crick: Mr. Bower, I wanted to take up one or two questions of broad principle with you as stated, one in each of your memoranda. I do not want to dispute them, I merely want to explore them with you. In your first document, in paragraph 13 you make the statement that "There is no difference in principle between stock and fixed assets; there is only a difference in timing and frequency in the shrinkage in value." Now that observation appears in and colours a good deal of what you say later on in the document. We are not, of course, here speaking of a moral or ethical principle, we are speaking of an intellectual principle and therefore may take it to a degree that there may be times when the qualifications of the principle, for example here, timing and frequency, may be so important as to outweigh the basic community of principle between the two things.—Such as? I mean I am trying to exclude market differences.

4352. You are?—Yes, that may answer your point, and that has developed since this memorandum. We would rather go by a general price index than by the market differences, which probably answers the query you have in mind.

4353. That was a large part of what I had in mind. I had in mind the analogy one might perhaps suggest, that one might equally say that there is no difference in principle between what we ask Macdonald Bailey to do and what we ask Chris Chadway to do. Here we have a situation in which there are two types of asset, one of which turns over very rapidly and one of which lasts a long time. The short-term assets are characteristically subject to violent fluctuations in value. On the whole the fixed assets, while they may fluctuate in value, are much more static in value.—They only fluctuate between the beginning and the end. During their life they do not fluctuate at all.

4354. It follows, does it not, that a great deal of success in business depends upon success in price policy in relation to buying the stocks at the right time and turning them over, and therefore that a large part of the risk that is inherent in stocks by reason of the susceptibility to violent fluctuation is a proper business risk?—Yes, market differences, yes.

4355. Changing the approach to this matter, would it be true to say that, at any rate in manufacturing business and to some extent in trade, to borrow at short term is a legitimate way of financing the turnover of your stocks?—Seasonal stocks.

4356. Only seasonal?—Normally, yes. You would not borrow on the minimum volume of stocks you must always carry.

4357. But it would in any circumstances be improper to finance fixed assets on short-term borrowing, even if you could get it.—You could not get it.

4358. Does not that suggest that a business is to some extent protected against the violence of price fluctuations in respect of stocks by the very fact that it finances them on short-term borrowing?—Yes, to the extent of the surplus to what you might call a minimum stock.

4359. Does it not seem to you therefore that the differences between these two elements of fixed assets and circulating stocks are so important as almost to set aside the similarity of principle which you lay down as the basis of your argument?—No, take the long-term trend; wholesale prices have gone up three and a half times since before the war. There is an extraordinary lot of differences which in the aggregate have multiplied the price by three and a half times, and that trend is here to stay. It is not going back again. It is that kind of long-term trend one has in mind in comparing stocks with fixed assets. They are long-term by their nature.

4360. It comes back to what you said at the beginning, that your problem in attacking this particular difficulty is to segregate those price fluctuations which you can attribute to monetary factors from those price fluctuations which are in the ordinary course of business and may be due to differences in supply and all the rest of it?—Yes.

4361. And that is what you are aiming at when, for instance, you adopt the general price index for the adjustment of fixed assets?—It was largely for that reason we changed our mind and would prefer a general index rather than a particular index of prices for a business.

4362. Does not your suggestion for L.I.F.O., or something like it, go beyond that point when you come to stocks? Are you not in fact seeking protection then against every sort of fluctuation in price?—No, because the adoption of a general price index modifies the operation of L.I.F.O. The ordinary running of L.I.F.O. means that you compare the price difference of that particular business at the beginning and end of the year, and adopt that as your price fluctuation factor. It might be 150 in that particular business, but if you come to look at your general price index, assuming you can find a satisfactory one, and you find that it is, say, 120, then one would adopt the 120 as the price difference in L.I.F.O. instead of 150, and by leaving that 30 in the profits one would bring the market fluctuations into the taxable profits and not exclude them from taxation. That is an important modification of what we said here.

4363. I was reading the passage here in paragraph 16 where it says:—

"The logical application of the principle would require that the debit against sales for stock consumption should be the replacement cost of the stock so sold."

That seems to me to be asking for complete protection against every price fluctuation.—Replacement now should be read to mean the opening costs increased by the price coefficient for the year.

4364. And not a precise. . . —No.

4365. Finally, you suggest certain reforms in respect of fixed assets on the one hand and stocks on the other. Having regard to the difficulties in which you suggest that business is now placed because of the incidence of taxes, do you attach the greater importance to the first or the second of those recommendations of yours, in respect of fixed assets on the one hand and stocks on the other?—It depends, I cannot say for business as a whole. To some businesses, like tobacco and distilleries, stocks are everything to them; to an engineering firm fixed assets are everything to them. I do not know whether fixed assets are equal to the volume of stocks; I think fixed assets are probably greater than the volume of stocks, so in size the problem is about the same. As regards the effect of not recognising price changes, not dealing with stocks is much more dangerous because the value of stocks is more volatile and you are likely to distort your annual results by keeping stocks on a F.I.F.O. basis rather than if you had them on a L.I.F.O. basis. It distorts them much more than failing to modify the depreciation charge because the depreciation charge is only a fraction of the total cost, whereas in the stocks it is the total cost of the stocks. So, from the point of view of national income statistics or anything like that and broad generalisation of that kind, I would say that stocks were more dangerous than fixed assets.

4366. Then you would be inclined to say that to adopt one of your recommendations would add to the difficulties of the situation? It is essential to have both reforms at the same time in your view?—Yes.

4367. Can I just divert your mind on to a much more entertaining subject, paragraph 19 of your second document. It has to do with gambling and I raise it because it is treated in the same section of your paper in which you treat what are commonly called capital gains. Now I assume, from the fact that you devote a separate paragraph to gambling, that you see no essential connection or similarity between gambling gains and capital gains as defined for the purpose of the United States Revenue Acts, and in general terminology?—There is a big difference. There is a paragraph devoted to gambling because it is a common topic as to whether gambling should be taxed or not. On capital gains in the American sense you do at least give value for money, but on gambling you do not.

4368. You would be inclined to treat the question of taxing the gains on property transfers as something quite distinct from the question of taxing gambling gains?—Quite.

4369. May we just look at your paragraph on gambling, because I take it that you would dismiss the question of taxing gambling gains within the field of income tax?—Yes.

4370. On the ground that in the aggregate there are more losses than surpluses?—Yes.

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[Continued]

4371. That of course is indisputable when one is speaking of aggregates, but you would agree, would you not, that the losses and the surpluses are very irregularly arranged?—Yes.

4372. That if one taxed the surpluses there would be no possible necessity to allow full relief for losses and there would be still less necessity to make any allowance for what is politely called the investment in the transaction. It therefore follows that there would be a substantial taxable surplus if on other grounds one wanted to do it?—Yes.

4373. Is there anything more in your argument than that? Have I missed the point of why you are opposed to moving gambling gains into . . . —Is not the argument here really this, that you are already taxing the winnings?

4374. To some extent.—By the betting taxes. You tax the pool at the source, and that is the fund which provides the winnings. You have taken away from each of the winners a proportion of his winnings in the proportion that he shares in the kitty, so in effect you have taxed the winnings already if you look at it that way.

4375. At a flat rate?—At a flat rate, yes.

4376. But you would still see great difficulty or objections, would you, to bringing the winnings from these operations into income for purposes of graduated taxation?—Yes, if you want to tax gambling, you should also tax gifts, should you not?

4377. I am asking you.—They are payments without consideration and they are not in the nature of an income which should be subject to income tax. It is not by any stretch of the word "income". It is spending money, but it is not income in the sense of something that comes from an expenditure of effort or an exchange of property. There is also great difficulty in administering a tax on gambling because the effect would be to drive gambling underground and you would only in fact tax that gambling which appeared above ground. You would never be able to follow that which was underground. You would have serious anomalies there, it is an unpleasant sort of thing altogether.

4378. Mr. Crick: I am glad to have your views on that, because that is very much more than you were saying in your document here.

4379. Mr. Carrington: Have you changed your views on stock since the document of 3rd January, 1952?—Yes.

4380. Have we got your current views in writing?—In the last document.

4381. Which document is that? I have got the document of 3rd January, 1952, and I have this later document giving answers to the questions under Part B. There is also the document* which was placed on the table for us this morning but we have not read that. In which of the documents do you set out your up-to-date views on the stock problem?—We have not got one, but in this fairly general one we speak of stock replacement reserve, L.I.F.O. reserve, base stock reserve, any of those were alternatives of stock replacement reserves and the L.I.F.O.

* Not reproduced in these Minutes of Evidence.

reserve was rather thought of in terms of replacement costs of a particular trade. The two modifications in view of that we have got are the abandonment of the actual replacement cost of those particular goods and the adoption of a price index rather than particular values, and also there are some flaws in L.I.F.O. which we want to see if we can get over if we can in a simpler way than the Americans do. Namely, movements in the volume of the stock because L.I.F.O. acts as a one way adjustment. It does not conform to the principle that we want to get at. If the stock is reduced in volume, it is never corrected thereafter. We want to get some means of remedying that vice or fault in L.I.F.O. which is also applicable to base stock, and I think the best way to examine it is to try to charge into production costs the actual costs, say several months ago, written up by the price index to today's costs, charge those costs into production costs and carry the difference to the price difference account. That seems to be the more fruitful line of inquiry than L.I.F.O. I am merely telling you that, not dogmatizing; that is the line on which our thought is rather working now, compared with 3rd January.

4382. I will not question you further on that, except to say this, that you are thinking about two points which I had noted to ask you on these documents here, namely what happens where there is a decline in volume, and also what happens where the stock is not quite of the same type at the end of the year as it was at the beginning? I do not say the trader has changed his business, but owing to development in design or development in mode of production, he has got a different type of stock at the end of the year than he had at the beginning. If you are looking at those points I will not question you further.—The price index answers the second point. The difference in character of the stock just does not matter going on the dollar value method under L.I.F.O. The first one does want examination of course. The Americans have one system of taking additions to stock by layers for each year, and as the stock falls they take off the top layer, then the next layer and so on: it is too complicated.

4383. I will not pursue this if you are going to look at these points. I only want to express my sorrow at hearing you say we shall be sitting here for five years.—I said we hoped to expect a report before five years.

4384. Mr. Woodcock: You do not think much of initial allowances, but if there were no possibility whatever of the adoption of your idea of taking into account current costs, would you still think initial allowances were of no use if that were the only thing possible?—I did not say "no use". I said of little use. Our view would not alter at all.

4385. May I put it a little more specifically? If you knew for a certainty that there was no possibility of adopting for tax purposes your suggestion, what would you then think of initial allowances?—Better than nothing, but no higher.

Chairman: Thank you, Mr. Heaton. These are all our questions, we are much obliged to you.

The witnesses withdrew

MR. BERTRAM NELSON AND MR. JAMES S. HEATON, on behalf of the Society of Incorporated Accountants and Auditors; called and examined.

MEMORANDUM SUBMITTED BY THE SOCIETY OF INCORPORATED ACCOUNTANTS AND AUDITORS

Terms of Reference

1. The terms of reference of the Royal Commission are limited by the proviso that its recommendations shall be "consistent with maintaining the same total yield of the existing duties in relation to the national income". It is regretted that this limitation has been imposed, since the main theme which is common to all the views expressed is that it is the actual burden of direct taxation which gives rise to the problems which commonly occur in the experience of the Society's members. Anomalies of incidence which would be unimportant if taxation were lower are, under present conditions, serious and dangerous. It is also regretted that the scope of the inquiries

of the Royal Commission is restricted to the taxation of income, without reference to other forms of taxation. It is difficult to isolate and define the incidence and effects of any one impost.

2. In the first stage of its inquiry, the Royal Commission has invited evidence only on general, social and economic questions. The accountancy profession is more directly concerned with technical matters of taxation procedure and it is hoped that at a later stage of the proceedings of the Royal Commission further evidence may be invited.

3. It is hoped that the Royal Commission may feel able to consider the submission that it is not precluded

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[Continued]

to balance exactly proposed reductions of taxes in some directions with corresponding increases in other directions: that it is therefore desirable to consider a series of reforms, which could progressively be put into effect where the total yield of taxes permits. It is on this basis that the evidence of the Society is submitted.

The Total Burden of Taxation on Incomes

4. Taxation on incomes is so heavy that there is no longer any "area of manoeuvre"—there is little scope for a shift of the incidence of taxation from one class of tax payer to another. It is frequently asserted there is still a reservoir of taxable capacity in the higher ranges of incomes, but if all incomes above £3,000 were confiscated, the increased yield would be relatively small, as can be seen from Table 42 in the 93rd Report of the Commissioners of Inland Revenue.

Total of incomes of £3,000 and over (1948-49)	£573,000,000
Number of individuals— 91,490 × £3,000	£274,470,000
Gross amount confiscated	£299,000,000
Deduct: Taxation yield already derived therefrom— Sur-tax	£105,000,000
Income Tax	£134,000,000
Net increment in revenue from confiscation	£59,000,000

The issues involved in confiscation are outside the scope of the present inquiry but the above statement serves to indicate the limitations of any increase in the rates of tax on higher individual incomes.

5. It is also clear that, with taxation at its present level, savings are inadequate. In the table above, the calculations relate to the fiscal year 1948-49 and to the standard rate of Income Tax at 9s. in the £. The Economic Survey for 1951 forecasts an increase in the national income for that year of some 25 per cent. over the 1948 income and the standard rate of Income Tax has been increased to 9s. 6d. The concluding portion of Chapter IV of the Economic Survey for 1951 is devoted to the "Finance of Investment" and attempts to compute the personal savings which are necessary. The figures in the relevant Table (26) may be summarised:—

	1951 Forecast £ million
Surplus on Central and Local Government Accounts	140
Corporate and other bodies— Depreciation Allowances	1,126
Tax Reserves of Businesses	536
Undistributed profits	780
	2,482
Less: Provision for stock appreciation by Companies and authorities	700
	1,782
Personal saving required (1950, £332 million)	445
Total sums required to be set aside	2,227

The commentary on the Table states that the table "shows the contributions that should be made towards the finance of investment in the form of undistributed profits and tax reserves, as profits increase with the national income."

Even after allowing for these contributions, a substantial problem remains. The final item of personal savings is a balancing item and shows what is needed if we are to avoid inflation. But when prices are rising and there is pressure on the cost of living, it seems much more probable that personal savings will fall than that they will show an increase of over £100 million. Further, the calculation is in calendar years and understates the fiscal problem."

Incentives

6. The effect of taxation on incentives must be considered in relation to marginal effort. The effect on the taxpayer's mind is what is important. It is not the actual addition to liability which arises from additional effort which matters—it is what the liability appears to be to the taxpayer. The system of charging income tax by reference to standard rate, with reliefs for earned income and family circumstances, and reduction in rate for part of taxable income, is not helpful in this direction.

7. The fact that earned income relief is limited to the first £2,000 of income, coupled with the fact that the liability to Sur-tax commences at the same figure, results in a very high increase in the effective rate of tax arising when earned income slightly exceeds £2,000. In certain cases this may dissuade an individual from accepting a more responsible position. From the examples below it will be seen that a married man with three children earning £2,000 has an overall rate of 5s. in the £ at 1951-52 rates but an additional income of £20 bears income tax and Sur-tax at a marginal rate of 11s. 6d. in the £. It is suggested that limitations of Earned Income Relief should be extended and made applicable to Sur-tax.

Similarly the graduated system of income tax has the effect that, when income increases and passes from one rate of tax to another, the proportion of tax on the marginal income is greater than the proportion of tax levied up to that point. This is shown by the following examples relative to earned income which have been based on the 1951-52 rates of tax and allowances:—

Earnings for year	Tax Payable	Average rate allowing for E.I.R.	Rate of tax applicable to a further £20 of earnings
Single Man			
£	£ s. d.	s. d.	s. d.
1,374	— — —	— —	2 3
200	7 10 0	9	4 3
450	62 10 0	2 9	7 7
2,000	65 10 0	6 6	11 6*
Married Man			
1,374	— — —	— —	2 5
200	7 10 0	6	4 5
450	62 10 0	2 3	7 7
2,000	61 10 0	6 ½	11 6*
Married Man with 3 Children			
500	— — —	— —	2 5
542½	7 10 0	3	4 5
812½	62 10 0	1 6	7 7
2,000	51 15 0	5 ½	11 6

(Family allowances and National Insurance Contributions ignored.)

* N.B.—Including Sur-Tax.

8. Considerable enquiries have been made as to whether the P.A.Y.E. system is at present having any serious effect on production. In the early days of the operation of the system there clearly was some effect on the incentive to work. The objections mainly arose through ignorance of the basic system of assessment and the mistaken belief that all additional earnings were taxed at 10s. in the £. The wage and salary earner now prefixes the P.A.Y.E. system of collection which endeavours to relate tax payable to actual earnings and there is little evidence at present of persons refusing to work overtime or limiting their piece-work or bonus earnings because of P.A.Y.E. If, however, there should be an increase in earnings as a result of increased production or inflation or should the income tax reliefs be reduced it may well be that the increase on the effective rate of tax would prove a serious disincentive.

9. Notwithstanding the lack of evidence mentioned, it is clear that the present system of collection of tax under P.A.Y.E. could be much improved from the standpoint of incentives. The effectiveness of the present method would be increased by the introduction of further gradations of reduced rate relief, so as to smooth variations resulting from movements from one code to another with additional earnings.

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If the rate applied to the first £50 of taxable income were 2s. 6d. and rose thereafter by 1s. 6d. by stages of £50, the overall average for the £250 now chargeable at reduced rates would be maintained at 5s. 6d. The reduction of 1s. 6d. on the first £50 would be compensated to some degree by the increase in the average rate on the remaining £200 from 5s. 6d. to 5s. 9d.

10. It might be possible to remedy the major disincentive defects of the P.A.Y.E. system by a more radical reform based on two principles:—

(a) The introduction of a new flat rate of tax for all earnings—a rate based on the normal standard rate less E.I.R.

(b) The payment of allowances, as a separate matter, through the Social Security procedure.

In no other ways does it seem possible to simplify and reform the P.A.Y.E. system thoroughly. Whether a radical change of this type is desirable depends on factors relating to the Social Security system of which the accountancy profession has little direct experience. As the merits of such a system have been the subject of strong recommendations a typical example is set out in Appendix A.

Risk Bearing

11. Taxation discourages new enterprise. If there is a profit, a high proportion goes to the State; if there is a loss, it often has to be met entirely out of risk capital, without tax relief. The present system of taxation (particularly Profits Tax) bears heavily on risk capital. Recommendations on this point are included in the section relating to Company Profits.

Savings

(i) Personal Savings

12. There is no doubt that the burden of taxation other than the system itself has a great effect on the encouragement of savings. So far as the system is concerned, however, the present Income Tax Acts provide a limited measure of relief from Income Tax but not Sur-tax in respect of contracts of life assurance. The Society's recommendations to the Millard Tucker Committee on Retirement Provisions contained suggestions for extending relief to the cost of providing pensions for self-employed persons and employees for whom no scheme exists. It is hoped that if this principle is adopted, savings will be encouraged.

13. In order to encourage savings to a greater extent than at present it is recommended that the system be altered in order to give life assurance relief to a parent taking out a whole-life or endowment policy on the life of his child. It may be convenient to limit the payments that would be available for such relief to, say, £15 per annum. Relief may be available under present law, if the policy is written on the life of the parent, but this expedient may not always be available.

14. Small savings could be considerably encouraged if interest on certain small investments were exempt from income tax. For example, each individual should be entitled to exclude from taxable income interest from deposits in the Post Office Savings Bank and Trustee Savings Bank up to £15 per annum. These sources would then be placed on a similar basis to that operating in the case of National Savings Certificates, except that such income should be stated in Income Tax Returns. It would, however, be logically necessary to extend this concession to all forms of savings; the cost to the Exchequer would be so considerable that the concession could only be justified if there were a paramount necessity to increase small savings, as an anti-inflationary measure.

15. In order to encourage the saving of business profits by a self-employed person it is recommended that the system be altered so as to levy Sur-tax only on the amounts withdrawn by the proprietor, subject to suitable safeguards against undue retention of funds, on the lines of the legislation applicable to companies (Sec. 21, Finance Act, 1922, as amended and extended*).

(ii) Company Savings

16. It is beyond doubt that under present conditions insufficient funds are being retained in a business adequately to finance normal development and the replacement of fixed assets. The remedies, which have been discussed so often as to require no amplification, include—

Reductions in the rate of tax.

Further considerations of reliefs for undistributed profits.

Further reform of the method of computing profits for tax purposes, so that taxable profits more nearly agree with profits computed on commercial lines.

Allowances for increased replacement costs.

It is assumed that these subjects will be considered in detail at a later stage of the proceedings of the Royal Commission.

Inflation

17. The system of amending the law relating to the charge to tax by an annual Finance Act, preceded by a review of the economic position in the yearly Budget affords a means of controlling inflationary or deflationary tendencies. The P.A.Y.E. system of collection of tax on employees' earnings has increased flexibility, because any variation in the rate of income tax and allowances and reliefs immediately affects the deduction of the income tax from wages and salaries, and therefore the purchasing power in the hands of the individual. Nevertheless, taxation is tending to find its way into costs. Whatever may be the theory of the matter this trend becomes more feasible when total demand exceeds productive capacity so that competition is largely ineffective. In relation to business profits, this may arise by attempts to maintain net income by passing on increases in tax liability to consumers, so as to maintain working capital. In relation to wage earners, the system of deduction of tax at the source unduly emphasises the net amount remaining after all deductions have been made, rather than the gross earnings: demands for wages increases are, in effect, based on net wages. Income tax, in these cases, has, therefore, a close connection with pressure for increases.

Balance of Payments

18. Under the present system, and subject to a measure of double taxation relief in some cases, United Kingdom Income Tax is charged on the profits of trades carried on in the United Kingdom, whether or not the persons carrying on the trade are resident in this country. The charge is also made on the profits of trades carried on elsewhere by persons ordinarily resident in the United Kingdom. These principles will tend to restrict the inflow of foreign capital.

There will also be a tendency to export capital to those countries where the burden of taxation is less than it is in the United Kingdom. It is considered, however, that this is due more to the rates of taxation operating here than to the system itself. Where businesses are transferred abroad so that control no longer remains in the hands of persons resident in the United Kingdom, there will be a tendency to lose not only in the form of a decline in the tax liability of such a company, but also by reason of the fact that the company may obtain its equipment and supplies from foreign sources rather than from sources in the United Kingdom. Some reference to this matter is made in Paragraph 304 of the Report of the Committee on the Taxation of Trading Profits, and it is submitted that companies carrying on businesses abroad should be assessed to United Kingdom Income tax on remittances only. It is appreciated that Clause 32 of the Finance Bill, 1951,* affects this matter.

The Distribution of Personal Incomes

19. Benefits by way of family allowances, health services and food subsidies now absorb about approximately one-third of the total Revenue raised by taxation. This taxation is being used as an agent for the re-distribution of income. It is submitted that this process has reached the limit of practicability.

* Now I.T.A., 1952, Part IX, Chap. III.

* Now I.T.A., 1952, s. 468.

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[Continued]

20. Existing provisions prevent a taxpayer from deriving benefit by divesting himself of income by means of an assuasive covenant except to individuals dependent on him, other than unmarried infant children. It is considered that these provisions are effective in preventing abuse and no further restrictions are desirable.

Other Economic and Social Objectives

21. There is considerable value in publicity and explanatory memoranda in helping tax payers towards an understanding of the taxation system. Valuable work was done in this direction when P.A.Y.E. was introduced and the effect of this has been apparent in the gradual improvement in the attitude of employees. It is felt that some momentum has lately been lost in this aspect of public relations.

Social Security Payments and Contributions

22. It is not desired to make a direct recommendation as to whether it would be advantageous to link income tax with Social Security payments and contributions. The advantage of such a scheme would be as follows:—

(a) As already suggested it would remove many of the anomalies of the P.A.Y.E. system.

(b) Eventually administration costs might be reduced. The disadvantages include the following:—

(a) The restriction of each 20s. of wages to 15s. (see Appendix A, paragraph 3), would be likely to provoke agitation for a compensating increase in rates of wages generally.

(b) The principle that the National Insurance Scheme should be self supporting would probably be lost, the burden of sick and unemployment benefits falling on the general body of tax payers.

(c) The change of procedure would possibly cause great administration problems. Problems would certainly arise with self-employed persons and persons with investment income.

In Appendix B* are set out some of the technical problems which would arise if the taxation and social security systems were integrated.

Taxation of Companies

(a) Profits Tax

23. On its introduction in 1937, the National Defence Contribution was a tax on the profits of businesses carried on in the United Kingdom or carried on elsewhere by persons ordinarily resident in the United Kingdom. Extraneous income was not charged, since it was the apparent intention of the legislature to have regard only to profits arising from the conduct of the business. Thus, investment income was charged if it comprised the whole or an integral part of a business, but not otherwise. Distinctions in the form of proprietorship of a business did not involve fundamentally different treatment. The change of name from the beginning of 1947 was the occasion for basic changes in the nature of the tax. It may be said that there was no longer a tax on business profits but on corporate income. This was effected by:—

(1) Exemption of profits from businesses carried on by individuals, and of profits from partnerships attributable to the shares of individuals.

(2) Inclusion within the charge of all income received by the proprietary company or other body, whether or not directly incidental to its business, apart from dividends distributed from profits already chargeable to profits tax.

At the same time, the changes were apparently linked with Sur-tax considerations. There was to be exemption from Profits Tax for any chargeable accounting periods relative to years of assessment for which the actual income of the company was apportioned amongst its members for purposes of Sur-tax. By a later provision, election for special advantages in relation to Sur-tax by underwriters was made conditional upon acceptance of liability to Profits Tax.

24. It is submitted that, in these circumstances the fundamental nature of Profits Tax should be re-examined. There are the following questions:—

(i) Is Profits Tax intended to be a tax of business profits with exemption of individuals on the ground that they, unlike companies, may be liable to Sur-tax on the whole of those profits, whether or not withdrawn for personal use? If so, on what grounds of logic is investment income taxed when it is not the whole or an integral part of the business?

It seems that the only answer is that all sources of the income of an individual are aggregated and are liable to Sur-tax.

(ii) If, on the other hand, it is appropriate to regard Profits Tax as an alternative to Sur-tax, on the ground that it makes up for the lack of an additional imposition which Sur-tax provides on individuals, then it would seem to be bound up with undistributed profits of companies, since income distributions would fall into the Sur-tax computations of the recipients. In fact, the nature of Profits Tax since 1947, with its exceptional bias on distributed profits, runs counter to this reasoning.

25. Whatever the answers to these questions, it seems that the Profits Tax is basically illogical to some degree, in having primary regard to the nature of the income, and secondary regard only to proprietorship elements.

An additional and specific tax on corporate income is objectionable also from the following standpoints:—

(a) Falling on equity holders as it does, it is a deterrent to enterprise and risk-taking.

(b) It is particularly severe on companies in which preference shares are a significant proportion of the issued capital.

(c) It encourages finance by way of loans, unsecured notes or debentures, instead of by permanent share capital, which would be more economically sound.

(d) It is an additional drain on current resources already, in general, highly strained by the high cost of replacement of raw materials and fixed assets.

(b) Questions of Residence, Ordinary Residence and Domicile

26. A detailed discussion of the application of taxation provisions on these matters to companies is reserved for Part B of the heads of evidence. It may be stated here, however, that clarification of the law is necessary in relation to the concept of ordinary residence as applied to companies.

Possible Merger of Taxes on Companies

27. It appears that the taxation of corporate income is at present on an illogical basis.

Some of the relevant factors are:—

(a) Whilst the Profits Tax has been alleged in earlier notes to be illogical in conception, the distinction drawn between distributed and undistributed profits can be used in an attempt to influence distributions according to whether conditions are inflationary or deflationary.

(b) Over the whole field of company profits, the double incidence of Income Tax and Profits Tax is excessive, particularly in relation to the resources necessary to maintain and to develop productivity.

(c) Since companies are regarded as separate tax payers, the Income Tax system must at present be conditioned by the applicability of its provisions to all tax payers in business. This point is emphasised in the Report of the Committee on the Taxation of Trading Profits, since some 200,000 assessments on business profits were made on companies, out of a total of 1,500,000, some 450,000 exempt cases already having been deducted in arriving at that larger figure. If company profits could have been considered in isolation, it may be that a change to some form of current-year basis of assessment, fairly generally desired, might have been devised. (Vide paragraph 41 of the Committee's Report.)

* Not reproduced in these Minutes of Evidence.

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[Continued]

28. It is suggested that inquiry should proceed on the following lines:—

(i) Incorporation of the distinctive treatment of distributed profits within the charge to Income Tax on companies.

(ii) Reservation of power to charge the distributed rate in the case of unreasonable retention of income, for use in the case of companies not within Section 21 of the 1922 Act.

(iii) Further consideration of some form of current-year basis of assessment of application only to companies, preferably by assessment on the profits of a chargeable accounting period (on the basis of Profits Tax) with apportionment of liability on a time basis in respect of variations in rates of tax.

(iv) Further consideration of the degree of variation of distributed and undistributed rates. Subject to variations in profits as computed for the purpose of Income Tax and Profits Tax and to questions of abatement effective total rates for 1931-32 are:—

Distributed profits—73.75 per cent.

Undistributed profits—52.75 per cent.

29. While Profits Tax continues on the present basis, it is submitted that a serious anomaly would be removed if fixed preference dividends were not included as part of the gross relevant distributions to proprietors.

28.6.1931.

APPENDIX A

Integration of P.A.Y.E. and Social Security Payments

1. Basis

(1) The introduction of a flat rate of tax on all earnings at a rate less than that charged on business profits and unearned income in order that E.I.R. may be taken into account.

(2) The flat rate of tax should be applied once and for all when the remuneration is paid.

(3) Allowances to be given by a system of coding on a weekly basis, co-ordinated with Social Security payments.

2. *Advantages.* The main advantages as previously indicated would include avoidance of distortions, comprehensibility and economy in administration.

3. *The operation of the system.* As an illustration of the operation of a flat-rate system, tables are appended comparing the liability under current law to Income Tax and national insurance contributions (less family allowances where applicable) with the proposed flat-rate liability. These are based as follows:—

(a) The first £2 per week (£104 p.a.) has been regarded as tax free.

(b) Each dependent (wife or child) has been regarded as available for a cash allowance of 12s. 6d. per week (£32 10s. p.a.).

(c) A flat rate of tax in excess of £104 p.a. has been applied to all earned income at the rate of 5s. 0d. and to all unearned income at the rate of 7s. 0d.

(d) A Surtax at the rate of 2s. 6d. has been applied to all incomes, whether earned or unearned, in excess of £650 p.a.

The effect of these rates is to produce tax on earned income of 7s. 6d. in excess of £650, which compares with the existing rate payable on such incomes under the present system of 7s. 7d. The rate on unearned income is 9s. 6d. in the £ which is the same as under the present system.

From the schedule it will be seen that married people in the lower income groups benefit quite considerably but that otherwise there is not a great deal of difference in the net taxes payable.

(Note: The above method is an illustration only and should be considered in connection with comments in paragraphs 8-10 and 22.)

COMPARISON OF NET TAX PAYABLE AND ALLOWANCES RECEIVABLE

Income	Single Person			Married Couple			Married Couple with 1 Child			Married Couple with 2 Children		
	Present Tax and N.I.C.	Proposed Tax.	Difference in Tax payable	Present Tax and N.I.C.	Proposed Tax less £32 10 0	Difference in Tax payable	Present Tax and N.I.C.	Proposed Tax less 66s	Difference in Tax payable	Present Tax and N.I.C. less £15	Proposed Tax less £27 10 0	Difference in Tax payable
£	1	2	3	4	5	6	7	8	9	10	11	12
EARNED INCOME												
200	19	34	+ 5	13	— 8	— 21	13	— 41	— 54	—	— 73	— 73
300	40	49	+ 9	19	16	— 3	13	— 16	— 29	—	— 48	— 48
400	62	74	+ 12	40	41	+ 1	21	9	— 12	—	— 23	— 23
500	91	99	+ 8	62	66	+ 4	43	34	— 9	14	2	— 12
650	148	136	— 12	110	104	— 6	77	72	— 5	47	39	— 8
1,000	281	268	— 13	243	235	— 8	210	203	— 7	160	170	+ 10
1,500	471	455	— 16	433	423	— 10	400	390	— 10	359	358	— 1
2,000	661	643	— 18	623	610	— 13	590	578	— 12	549	545	— 4
UNEARNED INCOME												
200	27	34	+ 7	12	1	— 11	12	— 31	— 43	— 1	— 64	— 63
300	55	69	+ 14	33	35	+ 2	16	4	— 12	— 1	— 29	— 28
400	88	104	+ 16	60	71	+ 11	41	39	— 2	— 9	6	— 3
500	135	159	+ 24	97	106	+ 9	69	74	+ 5	36	41	+ 5
650	207	191	— 16	169	159	— 10	135	126	— 9	89	96	+ 7
1,000	373	357	— 16	335	325	— 10	302	292	— 10	245	260	+ 15
1,500	610	595	— 15	572	562	— 10	519	510	— 9	453	459	+ 6
2,000	846	832	— 14	810	800	— 10	777	767	— 10	730	735	+ 5

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[Continued]

EXTRACT FROM SECOND MEMORANDUM SUBMITTED BY THE SOCIETY OF INCORPORATED ACCOUNTANTS AND AUDITORS

Question 5 (a). *Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be?*

Capital Gains

13. We have considered whether a tax on capital gains should be introduced, and are convinced that it is neither practicable nor desirable.

14. So far as bodies corporate are concerned, a dividend paid out of a source of capital profit forms part of the distributions taken into account in computing liability to profits tax. Even though the increase in that liability which follows on such a dividend is in form a tax upon the company's trading profits, its effect is to charge any capital gains distributed to shareholders with Profits Tax at a rate which, after allowing for the interaction of Income Tax liability, amounts to approximately 4s. in the £.

15. A tax on the capital gains of the individual in a time of depreciating currency is attended with many difficulties. Such a tax must, if it is to be equitable, be restricted to realised gains. Such gains are, to a very large extent, only the reflection of the fall in the value of the £. If A who bought his residence in 1933 for £1,500 sells it in 1951 for £5,000, with which he buys a precisely similar house in another district, can he be truly said to have gained £3,500 by the transaction?

16. If gains which are reinvested in capital assets are to be exempt, how are we to defend the disparity in treatment between B and C in the following examples?

B bought a motor car for £200 in 1938. In 1951, finding that he could no longer afford to run it, he sold it for £350, which he used to pay for his travelling by public conveyance. A capital gain of £150 arises.

C bought a motor car at the same time and at the same price. Having prospered in business, he exchanges the car in 1951 at a value of £350 in part payment of a more expensive vehicle. On the basis of the argument in para. 15 no liability to capital gains tax should attach.

17. A further difficulty is the practical one of enforcement of the tax. It has been suggested to us that this could be overcome by requiring a quinquennial return of capital assets. We are, however, impressed by the practical impossibility of imposing an adequate check upon such returns, and the encouragement that would be given to owners to invest their capital gains in easily concealed property. So long as taxation remains penal at its higher levels it tends, in our experience, to place an undesirable strain upon the honesty of the taxpayer, and we should wish to see some scheme of additional taxation imposing a further burden on the honest taxpayer which the less scrupulous could readily evade.

18. These are, however, not the only objections to the taxation of capital gains. Realisation of profit must precede taxability, while taxation of profit must be coupled with some form of allowance for losses. In times of falling markets there would in consequence be every inducement to the speculator to sell his investments at a low

price, in order to obtain the benefit of a loss claim, and to follow the sale by a purchase of similar items after a short period. The real loss resulting from this type of transaction might well be far outweighed by the taxation advantage. Such operations would tend to unbalance the market at a time when stability was particularly desirable.

19. In times of rising prices a precisely opposite result would follow, buying being encouraged and selling artificially restricted.

20. It may, we think, be sometimes overlooked that so-called capital transactions may amount to the carrying on of a trade or of an adventure in the nature of trade so as to be taxable under the existing law (*cf. Ruedge v. C.I.R.* [1929], 14 T.C. 496, *Fraser v. C.I.R.* [1942], 24 T.C. 498 and *MacMahon and MacMahon v. C.I.R.*). The remedy, if real profits are escaping taxation on a large scale, may lie in a more robust attitude of the Inland Revenue to "schemes of profit-making" (*cf. California Copper Syndicate v. Morris* [1904], 5 T.C. 139).

Question 5 (b). *Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?*

21. On the whole, we consider that the present distinction is satisfactory in practice, although anomalies arise in border-line cases as they always must wherever the line of demarcation is drawn.

22. We refer, however, in a later paragraph to the effects of the decision in the *Law Shipping* case.

23. The report of the Committee on the Taxation of Trading Profits (Cmd. 8189) asserts that the theoretical view which requires "that a proper system of computing profits must necessarily take into account changes in the value of money" is a view which "is certainly not generally accepted by the majority of accountancy opinion." The Council of the Society of Incorporated Accountants and Auditors wishes it to be known that it is not in complete agreement with this assertion.

24. Accounting practices as now applied to the periodic measurement of business income were conceived in a period of relative price-level stability. In the past decade persistent depreciation in the value of money has called into question with gathering momentum the validity of some of these practices and has reached a point which compels their re-examination. The finance required to preserve operating assets so as to maintain production is a cause of anxiety to all who are concerned with the management and efficiency of industrial enterprise. There exists a serious danger of real capital consumption which accounting practices tend to veil.

25. The Council of the Society has therefore set up a representative committee to re-examine the theoretical view to which the Committee on the Taxation of Trading Profits refers, with the object of making recommendations possible of acceptance by both the business community and the accountancy profession.

13.2.1952.

EXAMINATION OF WITNESSES

4386. **Chairman:** We are grateful to you for the papers you have sent in. Of course on a number of matters of detail we shall not trouble you with questions, but there are one or two questions on major points that you will probably be able to clear up. Will you take your first document, and look at paragraph 8? You are giving us there, I think, some practical experience as to the effect of the P.A.Y.E. system on production. You start your paragraph by saying:—

"Considerable enquiries have been made as to whether the P.A.Y.E. system is at present having any serious effect on production."

Then you make the point that, when it was first introduced as a system of taxation, naturally it was widely misunderstood and provoked a good deal of resentment, but it is your experience, is it, that a good deal of that particular reaction has disappeared?—**Mr. Nelson:** Yes,

there are always disincentive effects following from a high rate of taxation, but the particular ones relating to P.A.Y.E. have considerably disappeared.

4387. You go so far as to say: "The wage and salary earner now prefers the P.A.Y.E. system of collection which endeavours to release tax payable to actual earnings..." Is that, as it were, the summary of the views which you have extracted from your members?—Yes, those of our members who made enquiries among their clients did find that the P.A.Y.E. system, so far as any system of taxation could be popular, was well received.

4388. Then in paragraph 10, I am not criticising this, but you start rather tentatively: "It might be possible to remedy the major disincentive defects of the P.A.Y.E. system by a more radical reform based on two principles". Is your position this, that you do not come forward as

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[Continued]

advocating that as being required or desirable?—It is a point on which we do not feel strongly.

4388. As an organisation. Very likely there are different views in your membership?—Yes.

4390. But you have worked out for us in a good deal of detail, which we are grateful for, in Appendix A how such a simplified scheme might be approached?—Yes. On the integration with the social security provisions we do not speak from direct experience and express no decided view.

4391. In paragraph 15, you say:

"In order to encourage the saving of business profits by a self-employed person it is recommended that the system be altered so as to levy surtax only on the amounts withdrawn by the proprietor, subject to suitable safeguards against undue retention of funds..."

The self-employed person you are speaking of there is an individual who is engaged in business activity?—An individual or, for that matter, a partner.

4392. But if you devise a scheme under which he was not taxed on the profits made, except so far as he withdrew them, would not that be giving him a very considerable advantage as against the other kind of self-employed persons who are not engaged in business?—The scheme would have to be carefully drawn. It corresponds in principle to the taxation of retained profits at a lower rate than distributed profits. Its purpose is to encourage saving within the business.

4393. You have self-employed people such as professional people who may be making considerable incomes but they would get no comparable reservation of any part of their income in that way, would they?—I think the term "business profits" would extend to professional profits, coupled of course with some change in the surtax rate so as to allow them earned income relief.

4394. If you introduce the earned income relief into the surtax range that would be a concession which would apply to all persons who were taxed for surtax?—Yes.

4395. But this would tend to be, would it not, a special concession to the self-employed person in business which would enable him, unless you could devise some counter scheme, to accumulate capital without paying tax upon it?—That is true.

4396. And the only sort of safeguards I suppose you have in mind would be whether the amount which he failed to withdraw, of the profits he had made, was reasonably required for the purposes of business?—The same kind of test as under section 21 of the 1922 Finance Act.

4397. That is about all the test which that offers, is it not?—Yes.

4398. Just a word on your next paragraph. You say "It is beyond doubt that under present conditions insufficient funds are being retained in a business adequately to finance normal development and the replacement of fixed assets." But the double requirement would be a considerable one, would it not, in a time when the purchasing power of the pound has depreciated considerably?—I agree.

4399. Because both to keep your real assets up to their volume and to develop normally would require a very large fund indeed, would it not?—That is certainly true.

4400. But now if we cut out normal development, which is after all an extension, would your impression be equally true that retained profits are insufficient for the replacement of fixed assets even at the enlarged prices?—Yes, with the present level of taxation, I think there can be no doubt on that subject.

4401. In your experience, I suppose this follows really, the weight of that kind of difficulty depends upon the structure of the business and its requirements to carry stock or to replace fixed assets?—It is a very general experience, but the degree of seriousness, of course, depends on the circumstances of the individual business. The experience is quite general.

4402. The experience is quite general, although I suppose from your experience you could point to particular industries which may be suffering peculiar difficulties in this way. Have you any in mind?—Any industry which has commenced a series of technical developments is always in difficulty. Difficulties are acute where there has been rapid technical progress.

4403. That throws up the obsolescence factor I suppose at once?—And there is also difficulty if there is a downward trend in trade. A business becomes short of working capital and it is necessary to realise stocks more rapidly than would normally be necessary. Therefore there are the two factors, the type of business and the state of the trade cycle.

4404. You would agree, would you not, that, overall, companies after taxation are retaining a very much increased proportion of profit than they did before the war?—The policy has been widely followed of retaining a much larger proportion of profits in the business to meet the difficulties to which we draw attention.

4405. But even with that change of policy, you would still say considerable difficulties are being experienced today?—Yes, the retained profits after taxation are still insufficient to provide for normal development and for the replacement of fixed assets, or indeed, for other factor taken separately.

4406. You say in paragraph 17 that taxation is tending to find its way into costs. Just how much is involved in that statement? Is it introduced in your experience as an element in the determination of the price policy?—In the absence of acute competition and in circumstances where the firm desires to retain sufficient working capital it is almost inevitable that taxation beyond a certain level will find its way into prices and therefore into costs.

4407. I was wondering how far? I can quite understand it would be done, but I was wondering how far actually your experience suggests it is an actual factor?—The need arises mainly from the necessity of remaining solvent. I do not think it could be put into terms of quantities, but the tendency is inevitably there with heavy taxation.

4408. I wanted to ask you something about your views expressed in paragraph 27. You have drawn our attention to what at any rate might be said to be certain contradictory tendencies in the present system of taxing companies or company profits. Have you considered the advantages or disadvantages of amalgamating all taxes on company profits into one tax?—Yes, we are attracted by the concept of a single tax on companies, incorporating the distinctive treatment of distributed profits, as for example in a profits tax. The complexities of some of the taxation statutes might be somewhat reduced, and we could perhaps combine that with a suggestion we make later on in our evidence* that in each Income Tax Act or each Finance Act some section of taxation law should be reviewed, codified and amended, so that over a period of years the whole taxation system might become somewhat simpler.

4409. But if you are thinking of combining, as you say, the various taxes which fall upon the company's profits today into one tax, you would envisage that tax as divorced from the standard rate of income tax, I take it?—Yes, except to this extent, that when a dividend was paid the deduction of the tax at the standard rate might continue, subject, of course, to double taxation provisions.

4410. Yes, but I was wondering how you would work it? I think you do advocate, do you not, in one part of your paper that distributions to shareholders should be regarded as a fresh taxable subject?—I think that might be one of the consequences of the single tax on companies.

4411. That would be a radical alteration of anything that we have known up to date?—Yes. Of course it might be possible to go further and to have the taxation liability on the current year basis at the same time.

4412. If you regarded all distributions of company profits to the proprietors as a new taxable subject, at some systems do, could you retain the valuable arrangement of tax deduction at the source?—I should hope so. It is a desirable principle and I should hope it could be retained.

4413. A very convenient administrative one?—Extremely so.

4414. What is actually meant by paragraph 28, sub-paragraph (i)? It is not clear to my mind what that means.—Mr. Beaton: That is I think the discrimination which already exists in relation to profits tax.

* Not reproduced in these Minutes of Evidence.

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[Continued]

4415. You borrow what you think is a good element in the profits tax?—To incorporate that distinctive treatment of distributed and undistributed profits.

4416. You would give some relief to retained profits?—Yes.

4417. Or some extra charge on distributed profits?—We thought the rate on distributed profits would be certainly not less than the standard rate of income tax, and therefore the net dividend received by a member could be regarded as a payment at least at the standard rate of tax by the company, even though it was not in the form of the normal standard rate of tax.

4418. You would be saying that, in so far as the company has paid its profits up to the standard rate of tax and then makes a distribution, that distribution could be taken as already having suffered tax; but that would not be treating the distribution then as a new taxable subject, it would be maintaining the present system.—Only so far as the rate may be involved, that may be a minimum rate. The actual rate suffered on distributed profit could be a good deal higher than the standard rate which is regarded as the measure of liability by an individual shareholder.

4419. That would be borne by the company; I follow that. I have one question on your other paper, on this question of capital gains which we are looking at at present. I wanted to make out what your general views on this subject were. You do not favour the introduction of capital gains as a taxable subject for income tax?—Mr. Nelson: No, we feel the practical difficulties are very great.

4420. Are these your two main points? You say that many gains, or what appear to be gains, are in your view illusory because the person concerned may be doing no more than exchanging one asset for another in terms of a depreciated pound. The house, of course, is a typical instance of that. I suppose it is true of investments for those who are wishing to maintain their income?—Yes, we agree.

4421. Then you say that in your view it is a difficult task to administer and might lead to strong temptation to evade.—That is so, and there is a third difficulty, that the allowance of losses presents great difficulties.

4422. Of course the temptation to evade does not matter if you can efficiently and reasonably economically control it, but this is a tax which would, in your view, be difficult to trace without a lot of administrative work?—I think it would increase the area in which evasion could take place with little chance of detection.

4423. One question on your answer to question 5 (b). We have been hearing a great deal of this question of the proper system of computing profits in a time of changing price levels, but your Society in paragraph 25 is poised between adopting a possibly new view and retaining what has been regarded as the accepted view up to now. Has anything happened since that paper was composed?—Conferences are about to take place between the professional accountancy bodies to elucidate this problem. It is probable that the view is growing that in computing distributable profits price changes must be taken into account to preserve capital, and to ensure continuance of the business. We have had an international congress on accounting where the same kind of difficulties have been disclosed by many speakers from many countries. The situation has been much affected by the extent of the change in price levels of these countries, but even here, whereas between 1880 and 1939 any temporary rises in prices ultimately have been levelled out, since then the price changes have continued and seem to be likely to be permanent.

4424. Is it your view that it is more likely, that principles with regard to the method of calculating or method of adjusting for stocks will be agreed as opposed to methods for calculating depreciation of fixed assets?—My personal view is that the stock problem is less acute than that of fixed assets. There are strong theoretical reasons for dealing with stock on a replacement basis by one of the methods available, but that problem is felt less strongly than the problem of fixed assets.

4425. When you say "less acute", I am not sure what you mean by "acute", less important to the business or more likely to solve itself in the course of time without radical changes?—The well-established principle of cost

or market price, whichever be the lower, does work well, whatever may be its theoretical defects. Moreover the stock change is more rapid than that of fixed assets in normal businesses, so while some consideration should certainly be given to the whole problem of inventories, my personal feeling is that the problem of replacement cost on fixed assets is more important and more difficult.

4426. Mr. Woodcock: In paragraph 16 of your first document, the Chairman has been asking you some questions on this, you say "It is beyond doubt that under present conditions insufficient funds are being retained . . ." Is it beyond doubt?—I think that the experience of accountants with their own clients is quite convincing, so far as our knowledge of their circumstances goes. Our practical experience in the day to day administration of our practices does show this shortage of retained funds. In addition of course the Commission has the evidence from the British Bankers' Association and the Federation of British Industries. We are impressed with the experience of many large companies which, after very heavy bank overdrafts, have had to have public issues. We are impressed with the difficulty of starting new businesses. The chairman of many public companies at their annual meetings have given particulars of the precise difficulties in relation to their own circumstances and we, in the ordinary course of our practice, do find this need arising in very many of the businesses where we advise on financial policy.

4427. Surely in these last six years of peace, the difficulty in this country has been to find the material and the labour, but not the money?—That has been a limiting factor but in many cases where there was no shortage of material, no shortage of labour, no difficulty about licences, normal progress has been held back by an insufficiency of funds.—Mr. Heaton: May we add to that, that it is not an immediate problem and we can see from balance sheets in our practices that, whereas there has been at the moment no difficulty of renewal or replacement because that replacement has not in fact been carried out, one can see the funds are not being accumulated to enable that to be done in due course; and this seems to us to be not entirely an immediate problem but one which will continue and in some businesses become more acute than has so far been apparent.

4428. Do you say we have not been able to maintain normal development and have not been able to replace our fixed assets and the cause has been shortage of cash? Is that what you are saying?—We say the need for replacement may not yet have arisen but the profits which have been retained so far are not providing funds which will later be required.

4429. That is not exactly what you say here.—I was merely adding to what Mr. Nelson said, that it was not entirely a matter of the immediate situation but that it was a continuing factor.—Mr. Nelson: Our experience I think is quite firmly behind these words "It is beyond doubt that under present conditions insufficient funds are being retained adequately to finance normal development and the replacement of fixed assets." That view is based on day to day experience of the businesses where we give financial advice, and we get evidence in the ways I have mentioned which supports our view there.

4430. Just one other question on paragraph 17. You are dealing with inflation and you say "demands for wage increases are, in effect, based on net wages." Is that the case?—Accountants do not spend much of their time on wage negotiations.

4431. I rather gathered that, Mr. Nelson, but you have made the statement. Do you know anything about the method of formulating and pursuing wage claims?—Certainly one of the factors is how much money is left in the pocket of the worker, measured against cost of living increases.

4432. Workers are taxed at different rates, some people are not taxed at all.—I quite agree, but I am sure one of the factors which does affect requests for increased wages is the amount left in the pocket of the worker compared with his weekly expenditure and that to some extent taxation does affect that factor.—Mr. Heaton: We were afraid too that that factor would be increasingly apparent if a flat rate of income taxation were involved and that is why, though we examined the problem in some detail, we could not give a recommendation directly on that point.

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[Continued]

We felt that if there was a flat rate there would be a greater temptation to regard the net amount received as in fact the level of the wage.

4433. You do not think that if the Chancellor reduced income tax there would be acquiescence in wage reductions, do you?—Mr. Nelson: I wish that he would try the experiment.

4434. Mr. Crick: Can I clear up one or two small points before I come to a more general one. On paragraph 14 you make certain proposals in respect of interest on deposits in the Post Office Savings Bank and Trustee Savings Bank, up to £15 per annum. If my arithmetic is right, I think that means a minimum balance through the year of £600. Why did you pick on that figure?—The purpose here is purely to encourage small savings and therefore we picked the figure at about the amount which the average individual might be able to save.

4435. Have you any idea how far tax is, in fact, collected on the interest upon amounts so small as £600?—We have no statistics.

4436. And you have no impression from your practice as to how far these amounts are in fact chased up?—Yes, we are thinking of the typical case of the working man with a salary of perhaps £10 or £12 a week. He comes in to the P.A.Y.E. category and, in fact, any savings he makes are probably picked up and therefore he suffers tax on the income of such savings. If he were encouraged to make modest savings up to the amount we have suggested the effect might be to improve the general level of savings.

4437. So that your observation is that this is a matter of importance, and large amounts are involved, are they?—Perhaps I should say it is a matter of fiscal policy in relation to savings rather than in relation to taxation. It depends for its value on the necessity of encouraging savings in the weekly wage earning section of the community.

4438. You go on to say that logically you ought to extend the concession but the cost would be so considerable to the Exchequer that you rather shy off generalising the concession. How important would the cost be in terms of revenue?—We have not been able to make any estimate.

4439. May I turn to paragraph 19? Here you submit that the process of re-distribution of incomes through the tax system and the social services has reached the limit of practicability. Do you suggest that re-distribution should go no further for practical reasons, or are you rather suggesting that it would be inadvisable, for reasons in your own mind and not stated here, that the process should be pressed any further?—I think our feeling is that with taxation at its present level the area of manoeuvre is very restricted. We speak there as accountants and not as experts on social matters.

4440. But it is on the point of practicability, as you state here, that you feel the thing has gone far enough.—Mr. Heaton: It seemed to us, Sir, that the re-distribution had really reached a maximum, taking the word practicability rather in the sense of what was really practical politics, having regard to the allocations which have already been made and to the level of taxation at present existing.

4441. You really use the word "practicability" in the sense of expediency or advisability?—That is so.

4442. I just wanted to get that clear. Your paragraph 21 I found very interesting. I wonder if you could give us one or two practical examples of what you would have the Inland Revenue Department do in this matter of public relations. There are few things more important in this whole field. What do you want them to do?—Mr. Nelson: Firstly, we found the explanatory memoranda on such subjects as war and tear allowances, research and patents extremely helpful. We should welcome any further similar explanatory memoranda. Secondly, I think benefit has been derived from the contact between the Inland Revenue and the employees in large factories where P.A.Y.E. was explained. Thirdly, in many ways the Inland Revenue keeps in close touch with accountants, giving lectures to our members, taking part in courses, and there again we find that a great help.

4443. You would like to see that sort of advice extended?—Yes.

4444. Do you feel that these printed documents, such as the popular presentations of the Budget two or three years ago, really have much serious circulation among the general public?—A relatively small circulation in relation to terms of population. It reaches many who are interested.

4445. Can I turn to your second document? There is a matter which puzzles me a great deal with regard to capital gains. I want to direct your attention principally to paragraph 19, which is simply a short statement of the converse of paragraph 18. You are suggesting, I take it, that in times of rising prices there will be a strong inclination in favour of the buying of securities and holding them, and a strong predisposition against the selling of securities. Is that correct?—Mr. Heaton: I think the point there was, Sir, that there would be reluctance to realise perhaps the capital profit immediately because of the liability attached.

4446. If there is a reluctance to realise securities, then does it not follow that there cannot be much buying?—That would not be the only factor in the market condition at the time of course, would it?

4447. What other factors have you in mind?—I think that has been already stated this morning. You could not perhaps isolate this one factor as one affecting the stock markets.

4448. That is true, that has been mentioned, but my question is rather this: If people are very reluctant to sell, does it not follow that the purchases must be on a very small scale?—Purchases may be new holding of stocks to start with.

4449. But somebody has got to sell if anybody is to buy.—Mr. Nelson: Would not in fact the result be that the price would fall until a buyer were found?

4450. Even then the volume of sales must be equated to the volume of purchases.—We quite agree, but we are pointing out here the fact that in practice the price would fall until a purchaser were found, and that might be a disadvantage.

4451. You are concerned solely with the price reflection and not with the yield of tax?—I think we are pointing out that if a capital gains tax did come into force the consequences, from the Stock Exchange point of view, might be quite notable.

4452. Might be?—Yes.

4453. You are not definitely stating that they would be?—I am afraid we have no means of carrying out a small term experiment to determine the extent of the price change.

4454. You cannot say on the basis of American or other experience that it would?—No, there is a general impression when you talk to accountants in the States that this has been happening. As has already been said to the Royal Commission the difficulty is to separate the results of taxation of capital gains from the results of other factors affecting Stock Exchange prices.

4455. Can I take you a little way from the details of your paper to a matter that really arises from paragraph 17. You speak about the anomalies of incidence which are serious and dangerous, and there of course you are speaking from your experience as accountants. I am inclined to think that your experience will carry all the more weight because of your connections in the profession rather than in London. Now you read the "Economist" no doubt?—I do.

4456. And last week there were some very interesting tables from which I extracted one fact, namely that the number of accountants in England and Wales in 1951, excluding articled clerks and people like that, was just under 14,000. In 1951 the number of accountants was 27,000; they have almost doubled. This is making two blades of grass grow where one grew before. Now I suppose that increase is partly accounted for by larger numbers employed in the public services and in business?—That is so.

4457. Would there be anything like a comparable increase in accountants in private practice?—An increase, but at a much lower rate.

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MR. BERTRAM NELSON AND MR. JAMES S. HEATON

[Continued]

4458. How far, if at all, would you attribute that to the concern of accountants with tax matters?—The rise in the practice side of the profession has probably been due to two main factors, firstly the increasing importance of taxation and the increasing burden of taxation, and secondly the growing interest of the profession in matters relating to the use of accounts for management purposes. More use is made of accounts than was made 20 years ago.

4459. You would say that the first factor is of quite considerable importance, the other one need not concern us?—Quite considerable importance.

4460. That means that you are much more occupied with tax matters than you were before the war. Would you say that that tendency is continuing, or is it modified, or is it reversed?—I confidently expect that the effects of E.P.L. will be to add to our hours of work and to our needs for staff. The growing complexity of taxation inevitably means more accountants must be engaged in taxation work for longer hours.

4461. That phrase "growing complexity" is important because I wanted to ask you how much of this pre-occupation is due to growing complexity and how far it is due to the increasing concern among taxpayers to minimise their tax liabilities, I mean minimise properly, to be quite sure that they are not paying more than their just due?—The two factors cannot really be separated. Whatever the rate of tax may be, it is the purpose of the accountant concerned to ascertain what is the true taxation. The real difficulty is the amount of time which now has to be spent on computations. At the same time it must be said of course that the increase in taxation has brought more small shopkeepers, for example, into the taxpaying class, and to that extent the very existence of taxation, apart from its complexity, has increased the calls on the profession.

4462. When you said "computations" just now, I take it you do not mean the sort of work that would be done by a clerical employee?—I am thinking particularly at the moment of E.P.L. computations.

4463. And you would agree that the bulk of this tax work has to be done by partners and not by staff?—The staff are responsible for the first stages; for example they would prepare schedules of inadmissible expenses so that later on the enquiries from the Inland Revenue may be answered.

4464. Is it normally the practice to have one partner specialising on tax matters?—It depends entirely on the system of the individual firm. The firm of size will probably have a specialist taxation department.

4465. And broadly speaking would you say that the concern of the profession is mainly with business profits or with private incomes?—I would not attempt any definite assessment. Business profits are certainly predominant.

4466. Could you give any sort of broad indication of the different factors of the field within which your main concerns arise? Are they matters of business expenses, are they matters of depreciation allowances, or what causes you most worry, would you say?—Firstly there are the ordinary problems arising on the ascertainment of the taxable profit. That involves consideration of what expenses are disallowable. Secondly there is the policy advice to clients as to the effects from a taxation viewpoint of possible courses of action. Thirdly there is the audit side where it is necessary to ascertain for balance sheet purposes the amount of taxation which should be brought into the account in one form or another, and fourthly there will be miscellaneous matters regarding double taxation, P.A.Y.E. and similar points of detail.

4467. On the whole, taking your recommendations in the mass, would they, do you think, reduce your concern with taxation problems, or would they be calculated to making things more difficult? I am thinking of such things as the adjustment of depreciation allowances for example.—I cannot see any substantial reduction for some years to come in the amount of work which has to be done by accountants on taxation matters. If taxation is heavy it has to be complex if it is to be equitable, because it has to deal with many varying circumstances. The price of a simple tax is very often inequity. But we would hope that firstly there could be a kind of annual review

of some section of the tax law to simplify that section, and secondly that some of the suggestions we make here might, over a period of years, slightly simplify matters. The factor which would perhaps have the greatest effect would be the single tax of companies.

4468. I think you mentioned just now as the second of your responsibilities the advice you were called upon to give as to the effect, from the tax point of view, of certain lines of policy the company might pursue. Does that imply that it is the duty of an accountant to call the attention of his client to any possibility of properly reducing his tax liability which hitherto has escaped him?—It is the constant purpose of the accountants' profession to give clients the best possible advice within the law as it stands.

4469. On the other hand, I suppose you would agree that it is the function of the accountant to stiffen the conscience of the taxpayer against those strains to which you refer in one of your documents?—I agree.

4470. My last question is whether you regard that as being a healthy development from the point of view of your profession in the long run?—I doubt if it is a healthy tendency in the long run.

4471. Is that because you feel that accountants ought to be more concerned with advising their clients on the conduct and management of their business and that kind of thing as well as the normal auditing functions?—I think accountancy is better used in promoting efficient production rather than in advising clients on the complexities of taxation.—Mr. Heaton: I think we might make it clear that we think the accountancy profession is exerting daily a salutary effect upon the conduct of taxpayers in relation to the Inland Revenue Department, and I think the Department is ready to acknowledge that in relation to qualified accountants. One is always in the position of being in the middle, as it were. One constantly has to bear a certain amount of criticism from clients who feel that they are bearing your professional fees, while you appear to be very much on the side of the Inland Revenue.

4472. Mr. Kaldor: May I go back for a moment to your paragraph 16 and the answer you gave to Mr. Woodcock? You say "It is beyond doubt that under present conditions insufficient funds are retained to finance annual development". Would you say that was equally true in this country before the war?—Mr. Nelson: The extent of the problem has greatly increased.

4473. You mean funds are more insufficient today than they were before the war?—Before the war there was what we thought of as the "Macmillan" gap, the small under-taking which was short of capital and had no easy way of getting access to funds.

4474. Is that because the requirements of development have increased, or is it because the funds retained have fallen in terms of real purchasing power?—Partly the result of much heavier taxation and partly the result of rising prices, which of course means that a larger sum of money has to be available to carry the same volume of stock.

4475. You say that after allowing for a rise in prices, and after deducting taxation, the sums set aside are less than they were before the war; that is your point, is it?—No, I do not think I would say necessarily less. It is simply that the funds available now are more insufficient than they were before the war.

4476. Is it because they are less, or is it because the needs are greater? It must be one of the two, must it not?—The needs are greater.

4477. Why are they greater than before the war?—Higher prices.

4478. I am sorry, I was trying to make allowance for higher prices, it is obvious there are higher prices. Obviously a firm needs to put aside more money than before the war to serve the same purpose if prices are higher.—I cannot assess the two factors separately.

* The Committee on Finance and Industry, of which Lord Macmillan was Chairman, published its Report in 1951 as Cmd. 3857.

MINUTES OF EVIDENCE

TAKEN BEFORE THE

17

ROYAL COMMISSION ON
THE TAXATION OF
PROFITS AND INCOME

SEVENTEENTH DAY

Friday, 1st August, 1952



WITNESSES

MR. GEOFFREY CROWTHER
MR. ROLAND BIRD

} Editor and Deputy Editor of
"The Economist" ...

Questions 4494-4659

MR. S. P. CHAMBERS, C.B., C.I.E.
MR. C. D. HELLYAR
MR. A. G. DAVIES

} The Federation of British
Industries

Questions 4660-4771



LONDON: HER MAJESTY'S STATIONERY OFFICE
1952

THREE SHILLINGS NET

TERMS OF REFERENCE

(As amended 11th March, 1952)

"To inquire into the present system of taxation of profits and income, including its incidence and effects, with particular reference to the taxation of business profits and the taxation of salaries and wages; to consider whether for the purposes of the national economy the present system is the best way of raising the required revenue from the taxation of profits and income, due regard being paid to the points of view of the taxpayer and of the Exchequer: to consider the present system of personal allowances, reliefs and rates of tax as a means of distributing the tax burden fairly among the individual members of the community: to make recommendations bearing in mind that in the present financial situation it may be necessary to maintain the revenue from profits and income; and, in so far as they make recommendations which would on balance entail a substantial loss of revenue, to indicate an order of priority in which such recommendations should be taken into consideration."

NOTE

For the guidance of intending witnesses the Commission published a list of the main heads under which evidence was invited. They explained that the list was not necessarily exhaustive and that witnesses could put in evidence on questions not specifically mentioned, provided that they fell within the Commission's terms of reference. The list is reproduced below.

A. General social and economic questions

1. Is the present system of taxation satisfactory, or could it be improved, in relation to :—
 - (a) incentives,
 - (b) risk bearing,
 - (c) encouraging savings,
 - (d) the control of inflationary or deflationary tendencies,
 - (e) the balance of payments, including the inflow and outflow to and from this country of capital for investment,
 - (f) its effect on the distribution of personal incomes,
 - (g) other economic and social objectives?

These questions can be considered in relation to the taxation of :—

- (i) salaries and wages (P.A.Y.E.),
- (ii) profits of businesses and self-employments,
- (iii) dividends and other sources of income.

2. Would it be advantageous to link Income Tax with social security payments and contributions?
3. Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

B. Particular matters

4. Is the taxation net drawn too widely or too narrowly in relation to :—
 - (a) the taxation of United Kingdom residents (companies or individuals) on overseas profits,
 - (b) the taxation of non-residents on United Kingdom profits,
 - (c) the definition of residence, etc.?
5. (a) Are there any kinds of profits or income which are not charged but should be; or which are charged but should not be? In particular—
 - (b) Is the present distinction between profits liable to charge and those not liable to charge as being capital profits satisfactory?
6. Is the basis of computing income from property under Schedules A and B satisfactory?
7. Should the present rules about deductions for outgoings and expenses be altered?
8. Are the provisions for relief in respect of double taxation satisfactory?
9. Should the present system of graduation by means of the exemption limit, personal allowances, reduced rate relief and Surtax be altered?
10. Should the existing differentiation between earned and unearned income be extended or reduced?
11. Are alterations necessary in the rules governing personal and other allowances?
12. Should the rules about the taxation of husband and wife be altered (a) as regards aggregation; (b) in any other respect?
13. Should P.A.Y.E. be altered or abolished?
14. Should the principle of deduction at source be extended or restricted?
15. Should the method of assessment to Surtax be altered, and in particular should it be deducted from salaries?
16. Are any alterations desirable in the system of administration and the functions of the various statutory bodies or persons connected with taxation?
17. Are any changes in the provisions against avoidance and evasion desirable?
18. Is any alteration necessary in the rules governing the taxation treatment of special classes of taxpayers (e.g., public corporations, co-operative societies, charities)?

MINUTES OF EVIDENCE TAKEN BEFORE
THE ROYAL COMMISSION ON THE TAXATION OF
PROFITS AND INCOME

SEVENTEENTH DAY

Friday, 1st August, 1952

PRESENT:

THE RT. HON. LORD RADCLIFFE, G.B.E. (Chairman)

MRS. VERA ANSTET, D.Sc.
MR. H. L. BULLOCK
MR. W. S. CARRINGTON, F.C.A.
MR. W. F. CRICK
MR. HARRY GILL, J.P.
MR. GEOFFREY HEYWORTH

PROFESSOR J. R. HICKS, F.R.A.
MR. W. J. KESWICK
MISS L. S. SUTHERLAND, C.B.E.
MR. J. MILLARD TUCKER, Q.C.
MR. E. R. BROOKES (Secretary)
MR. D. G. DAYMOND (Assistant Secretary)

MR. GEOFFREY CROWTHER and MR. ROLAND BIRD, Editor and Deputy Editor of "The Economist";
called and examined.

MEMORANDUM SUBMITTED BY MR. GEOFFREY CROWTHER AND
MR. ROLAND BIRD

Question 1. Is the present system of taxation satisfactory or could it be improved in relation to:

- a. incentives;
- b. risk bearing;
- c. encouraging savings;
- d. the control of inflationary or deflationary tendencies;
- e. the balance of payments, including the inflow and outflow to and from this country of capital for investment;
- f. its effect on the distribution of personal incomes;
- g. other economic and social objectives?

These questions can be considered in relation to the taxation of:

- i. salaries and wages (P.A.Y.E.);
- ii. profits of businesses and self-employment;
- iii. dividends and other sources of income.

1. Any system of taxation, and particularly any system of very heavy taxation, has damaging effects upon such things as incentives, risk-bearing, thrift, etc. One must beware of ascribing to the existing system defects that are inseparable from any system that has to collect over 40 per cent. of the taxable national income. The practical way of looking at the matter is to inquire whether the present system could be improved, in the particular respects under consideration, without reducing the total yield of revenue. It is from this angle that the following comments are offered.

2. The chief remediable defects of the present system of taxation of income and profits are, in our opinion, the following:

- i. It imposes a greater deterrent on work and enterprise in these respects

the very high rates of tax on earned incomes above the £2,000 level (where the effective marginal rate on earned income suddenly changes from 38 per cent. to 57½ per cent. and thereafter rises very sharply) and a distinct disincentive to effort of a kind that is generally assumed to be particularly valuable to the community;

the large jumps in the rate of tax deducted from wages under P.A.Y.E. appear to exert some disincentive effort. (We do not lay great stress on this point, as in our opinion the main causes of the present relative lack of incentive among wage-earners are to be sought elsewhere than in taxation.);

profits tax, falling, as it does, with great weight on precisely those portions of companies' income which are of greatest interest to the average management—namely, equity earnings and allocations to reserve—has an undoubted disincentive effect upon industrial, and particularly commercial, enterprise.

ii. It penalises very heavily what has become one of the most important sources of savings—namely, the undistributed profits of industry.

iii. It tends to exaggerate the amplitude of industrial fluctuations in the following ways:

the basing of depreciation and obsolescence allowances upon historical cost makes profits in a period of inflation seem larger than they really are and this leads to an excess of optimism, while in periods of falling prices and bad trade the opposite tends to occur (though less certainly);

the fact that income tax, even on personal incomes, is levied on an annual basis makes it difficult or impossible to alter the rates of taxation except at twelve-monthly intervals. This may mean that rates of taxation that are required to produce a disinflationary surplus cannot be introduced until some time after the need for them has become apparent; in other circumstances a parallel difficulty might occur in promptly creating a reflationary deficit.

iv. The equity of its incidence between different sizes of personal income is a matter on which opinions may legitimately differ. But in our opinion it is clear that the distribution of the burden among persons of differing circumstances within the same income group is unfair. The various allowances for dependants were never large enough to match burdens to true tax capacities and with the fall in the value of money they have become very much too small. Also, the fact that (with the exception of earned income relief) they are fixed sums of money and not proportions of income means that the difference in tax burden between taxpayers with and without dependants becomes progressively less as income rises. When the total burden of tax was low, this could be overlooked. Now it is an unpardonable inequity.

v. With the growth of the welfare state, and of taxation to pay for it, there has also grown up the inequity of granting no relief to those who save the state expenditure by "contracting out" of one or more of the welfare services.

vi. The system of taxation has also become so complicated as to be almost unintelligible to all but the

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MR. GEOFFREY CROWTHER AND MR. ROLAND BIRD

[Continued]

expert. It is safe to guess that not more than one taxpayer out of ten could explain how his assessment is arrived at.

3. On some of the above points we do not propose to say anything more in the present memorandum, since they are certainly familiar to the Commission. On other points, more is said below in answer to later questions. There is, however, one general point we should like to make here.

4. The British income tax has for a century and a half been a magnificent instrument of good government, and one should hesitate before tampering with it. Indeed, with one exception, we do not suggest any amendment of the law relating to the definition of income or profits for taxation, or much amendment of the machinery for assessment or collection—and these are the things that one mainly has in mind in referring to the British system of income tax. But so far as the determination of the rates of tax is concerned, we think that the time has come to abandon the "standard rate of tax"—that is to say, the principle, now so very much amended and modified, that there is one "standard" rate which, in the absence of special circumstances, should apply to all forms of income. Many of the complications of the present system are due, we think, to the effort to force so many different kinds of income, and so many different sorts of circumstances within each kind of income, within the Procrustean bed of the standard rate. There should rather, within the general definition of taxable income, be three separate taxes—

(a) A universal personal income tax, very simple and intelligible in its structure, collected by deduction at the source.

(b) A graduated surtax for the larger incomes (including within "larger incomes" many more than are liable to surtax now—e.g. starting perhaps at about £600 p.a. gross income). This would, of course, be superimposed upon (a); it would be individually assessed; and collected, presumably, after assessment.

(c) A tax on the earnings of companies other than those paid out to individuals.

5. We realise that the fiction (for such it is) has certain administrative conveniences, which would disappear under this scheme; but in our view the disadvantages of the standard rate have come to outweigh its advantages.

Question 2. Would it be advantageous to link Income Tax with social security payments and contributions?

6. We have no doubt that it would be an advantage to link income tax with the system of national insurance, if it could be done. Indeed, we think that the advantages would be so great as to be worth paying quite a price for—for example, if it could be done only by a fairly complete recasting of the present scale of progression, it would still, in our opinion, be worth considering. It may well be that some of the simplifications of the present tax structure that would be made necessary by such a scheme would be worth while on their own account. For example, we think it probable that any attempt to construct a simple and intelligible system of taxation of weekly wages would lead to the separation of the calculation of allowances due from the calculation of tax to be paid—which would also be one of the first steps towards a linked system.

7. On the other hand, we can see the formidable difficulties of any such undertaking, and we have not examined any of the particular schemes proposed with enough care to be able to express our opinion (even were we otherwise qualified to do so) on its practicability. We must therefore confine ourselves to expressing the hope that the ingenuity of the Inland Revenue would be sufficient to produce a workable system, once they were relieved of the requirement that the present incidence of taxation must be exactly reproduced.

Question 3. Is the present treatment of companies for taxation purposes satisfactory or should it be altered?

8. This is the part of the whole area where the defects of the present system are, in our opinion, most glaring. There are three main defects:

(a) We are firmly of the opinion that replacement cost, and not historical cost, should be the basis of calculation of depreciation allowances. We feel sure

that we are utterly incapable of saying anything on this point that is not tediously familiar to the members of the Commission, so we restrict ourselves to indicating the side of the controversy to which our support is given. But it is given very firmly and we are ready to argue the case if the Royal Commission so desire.

(b) Profits Tax seems to us to be about as ill-conceived a tax as can well be imagined. No one has described its major defect more clearly or forcefully than its author, Dr. Hugh Dalton, in the treatise on public finance that he wrote many years earlier. Indeed, the only worse tax that we can imagine is the tax on excess profits that is now proposed. There may be a case for widening the differential between the taxation of earned and unearned incomes. On that we express no opinion, since it does not seem to us to be a matter susceptible of proof. It is a matter for political decision and it may be that, in spite of the burden of estate duty (so often forgotten in this comparison), the spirit of the age dictates a widening of the differential between earned and unearned income. But to meet this desire by levying a tax that falls exclusively on equity savings and allocations to reserve (and which, however earnestly it is aimed at the former, tends in practice to fall with particular weight upon the latter), and to leave all other forms of unearned income untouched, seems to us to be pernicious in the highest degree. Indeed, if there is to be any discrimination between different forms of unearned income, it should be in favour of the two categories that are directly related to incentives, to risk-bearing and to the supply of savings for capital formation. The aim should therefore be to abolish Profits Tax altogether and to recover the yield (which must, of course, be calculated net of the relief from income tax occasioned by Profits Tax) by heavier rates of income tax on unearned incomes. If this cannot be done all at once it should be done by stages.

(c) Even apart from Profits Tax, the existing system of taxation discriminates harshly and unfairly against the "ploughing back" of profits by established companies. Opinions differ on whether it would be right to discriminate in favour of "ploughing back" as compared with other forms of saving, and the arguments on either side are doubtless familiar to the Commission. We doubt, however, whether anyone would argue, as a general proposition, in favour of discrimination against "ploughing back". Yet this, we believe, is the effect of the present system. This result arises from the tyranny of the standard rate, of which it is, in fact, an excellent illustration. There is a tendency to argue that, since undistributed profits bear taxation (in the absence of Profits Tax) at the standard rate, they pay only as much as any other form of savings. But this is not so. For only a very small minority of individuals pay tax at a rate, calculated on their gross incomes, that is as high as the standard rate. (A married man with two children would have to have an unearned income of about £3,600 before his tax liability rose to 47½ per cent. of his gross income, if he had any earned income, any life assurance, any allowable expenses or charges upon income, the figure would be still higher.) What is more, a steadily growing proportion of the "institutional" savers pay tax at less than the standard rate, since life assurance funds pay at 7s. 6d. in the £ and pension funds pay no tax at all. There are two routes by which some part of the earnings of industry find their way back into capital investment in industry. The first is by direct "ploughing back". The second is by being paid out to shareholders and bondholders and then attracted back by public issues or other means of raising capital. We believe that if it were possible to discover exactly what rate of taxation was borne, on the average, by income moving along each of these alternative routes of conversion into capital, it would be found that the former route bore a heavier, and quite possibly a much heavier, rate of tax than the latter, even in the absence of Profits Tax. (Profits Tax, of course, makes the comparison much worse.) We think it would be difficult to justify this state of affairs by any argument either of equity or of policy. In any reconstruction of the income tax, therefore, the rate of taxation to be levied on undistributed profits—or at least on that portion of them

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[Continued]

that is "ploughed back" in such a way as to increase the capital employed in the business—should be lower relatively to the rates to be levied on other forms of income than is the case at present.

We are tempted to go further and suggest that, if a special rate of tax were to be fixed for profits "ploughed back", the rate to be paid should be determined, not by the date on which the money is originally earned and set aside, but by the date on which it is actually spent in the formation of additional capital—for which there is a rough and ready definition available in the wartime E.P.T. definition of "capital employed in the business". In practice, this would mean that tax would be paid at a certain rate in the first place, and then either a rebate paid or a supplement levied at the time of disbursement. We can see some such system as this providing a most powerful instrument for increasing or diminishing the rate of capital expenditure in the interest of a policy of economic stabilisation.

Question 9. Should the present system of graduation by means of the exemption limit, personal allowance, reduced rate relief and surtax be altered?

9. In our opinion, the present system of graduation is defective both at the bottom end of the scale and (at least for earned incomes) at the top end. At the bottom and the defect is that the "steps" are too high, causing some disincentive effect in their neighbourhood. We doubt whether this can be adequately remedied without a complete re-casting of the tax on the lines suggested above (Question 3) and below (Question 13).

10. At the top end, the defect is that the progression is far too steep. We have already mentioned the jump from 38 per cent. to 57½ per cent. at the £2,000 level. Thereafter the rise is very steep. The combined rate reaches 65 per cent. at £3,000 and 75 per cent. at £5,000. With the present value of money, these cannot be accounted excessive professional incomes, and are becoming on the low side for business executives. We feel sure that they exercise a very considerable disincentive effect. Moreover, when such high rates of tax are combined with rapid inflation, men in these income ranges feel themselves trapped; there is no means open to them by which they can keep up a standard of living which, in terms of past years or other countries to-day, is no more than one of reasonable bourgeois comfort. The remedy, we think, is to grant some relief to earned incomes above the £2,000 mark. Perhaps the simplest method would be to grant the one-fifth earned income allowance without upper limit (or at least up to £10,000), but to apply it to income tax only, not to surtax. At present this would mean that the combined rate of income tax and surtax would, throughout the range, be 9½ per cent. less on earned incomes than on unearned. The effective combined marginal rate would then become 55½ per cent. at £3,000, 65½ per cent. at £5,000, and would not rise to 75½ per cent. until £8,000. We cannot calculate the immediate loss of revenue that would follow from this relief. But it would certainly be small, and we feel confident that within a very few years there would be no

loss at all, because the present rates on the higher earned incomes have long since passed the point of diminishing returns. The value to the state in increased incentive would be considerable.

Question 10. Should the existing differentiation between earned and unearned income be extended or reduced?

11. We have included some comments on this in our answers to Questions 3 and 9.

Question 11. Are alterations necessary in the rules governing personal and other allowances?

12. We think that children's allowances, instead of being a fixed sum, should be a proportion—perhaps a progressively diminishing proportion—of gross income, with an upper limit. We should also like to support the proposal that some allowance should be made to those who voluntarily relieve the state of the burden of educating their children. We realise, however, not only that these proposals would come up against political opposition (misguided, in our opinion) but also that they would be costly in terms of revenue lost—in other words, that to adopt them would mean fixing the general rates of taxation higher than would otherwise be necessary.

Question 12. Should the rules about the taxation of husband and wife be altered (a) as regards aggregation, (b) in any other respect?

13. This is another area where reform would inevitably be expensive. But we record our view that, as a matter of equity and also, in the medium and higher ranges of income, of incentive, the earned incomes of husband and wife should not be aggregated. To confine the concession to earned incomes would have the incidental practical advantage that it would make it much easier to prevent improper advantages being taken of it than if it were extended to unearned incomes.

Question 13. Should P.A.Y.E. be altered or abolished?

14. P.A.Y.E. is at present a very cumbersome and largely unintelligible tax, and it should be simplified. The complexities seem to derive, in the main, from (a) the decision to keep the annual basis of assessment, and (b) the desire, when it was instituted, to reproduce exactly the complicated system of allowances and reduced rates—that is, to make it merely a new method of collecting income tax rather than a new form of tax. In our opinion, the way to simplify it is to remove these two difficulties. Income tax on wages and salaries should not be an annual but a weekly or a monthly tax, according as the income is received. The allowances should become a separate operation, with each taxpayer given a book of vouchers (like a pension book), dated for each week (month) of the year, which he could lodge with his employer as a credit against his tax deduction. The tax itself could then be either a flat rate on all wages from the first penny, or else a very simple and smooth form of graduation. This would save an immense amount of book-keeping and make the result intelligible to other than trained accountants. It would not entirely get rid of the "step" difficulty, but would make it smaller and less apparent.

22nd January, 1952.

MEMORANDUM SUBMITTED BY MR. GEOFFREY CROWTHER

Answers to "List of Economic Questions"

1. I have deliberately kept the following answers as brief as possible. I am, of course, ready to amplify any of them if the Commission so desires.

Question 1. To what extent is it desirable or expedient to use the taxation of incomes and profits specifically as instruments of (a) monetary policy (as by the creation of a disinflationary surplus or deliberately contrived Budget deficit), and (b) economic policy (as by measures, e.g., differential rates of profits tax, granting or withholding of "initial allowances", deferment of depreciation allowances, to encourage the ploughing back or distribution of profits or the acceleration or deferment of fixed capital expenditure)?

2. I do not think one can dogmatise about the extent to which it is possible or desirable to use taxation for these

purposes. Generally speaking, the strictly economic arguments are in favour of using it very considerably, while the chief arguments against are those of technical practicability and political prudence, on which an economist's judgment is no better—and, since his professional arguments point the other way, perhaps worse—than anybody else's. My own judgment suggests to me that the use of taxation for these purposes could go very much further than has hitherto been attempted. The chief practical limitations seem to me to be (a) the risk that, in spite of the best intentions, the result will be permanent deficit financing (though I grant that the experience of the past four years points the other way); and (b) the risk that tax rates and provisions may be altered too often—not, indeed too often to keep pace with changing economic conditions, but too often to permit sound long-term planning by industry.

[August, 1952]

MR. GEOFFREY CROFTHER AND MR. ROLAND BIRD

[Continued]

4504. It would follow, would it not, if I follow your thought that with the separate taxes which can pile up upon a company's profits today, the income tax which it bears, the profits tax and the excess profits levy, you would advocate their being taken away and all being represented by the tax on corporate profits?—Certainly.

4505. The next branch of the tax system is what you call a universal personal income tax, collected by deduction at the source, and you see that, if I follow it, as something which would apply to all incomes not only to what I may call the lower slices of income. It cannot all be deducted at source in that sense, can it, if one has got to take in all incomes, the self-employed person, the individual trader?—I suppose there would have to be exceptions. What I had in mind is that so far as is administratively possible it should all be deducted at source.

4506. So far as you apply it to something like wages and salaries then you can envisage it as deducted by a simple method at source?—I think that was in contradiction to the one in the next sub-paragraph as being tax after direct assessment.

4507. By direct assessment, yes. I think if you follow it out, the simple tax, there are difficulties, are there not, with regard to persons who have more than one source of income, because you have got somehow to make arrangements for a personal allowance. You do envisage a personal allowance even in the universal simple tax?—That is so, and that is why it has always seemed to me (I am not quite sure whether to use the singular or the plural pronoun, but perhaps my colleague will intervene if he disagrees) it has always seemed to me the provision of allowances would have to be made by some separate operation.

4508. Yes.—I have always been a little bit hesitant of advocating this too definitely because I think one would have to have a great deal of technical knowledge, knowledge the Board of Inland Revenue would have, to be sure that it is workable. The principle would seem to be this, if one could evolve a standard flat rate tax which is, so far as possible deducted from all incomes at the source, from the first penny onwards, and then the taxpayer was given his tax allowances by a separate operation by something like, for example, the pension vouchers that a pensioner gets. In the great majority of cases he would lodge these with his employer or one of his employers and have it directly offset as a simple operation. But the assessment of tax on the one hand, and the allowances on the other, should be separated and become distinct operations.

4509. On branches of that scheme we have already had a certain amount of representations about it, but it sometimes comes to a choice between deciding everybody should have, as it were, a credit regardless of the amount of tax he pays, or indeed whether he is a taxpayer at all, or only have a credit against such payments as are due to him, such as wages.—I have always thought the universal credit is a most attractive idea, but in the present state of British public finances we should hesitate a very long time before advocating it. As the first step, one ought to think about the second alternative that we suggest.

4510. That covers I think one or two of the questions I was going to ask you about the wage tax which I think you deal with at one point. You do, I think, advocate a truly weekly or monthly conception of a wage tax, in other words by transactions in relation to the week or month. You forgo the conception of the annual tax?—That is so.

4511. And annual allowances due on that basis?—If I might add to that: that becomes of course much more acceptable once one conceives of a single rate of tax, a flat rate of tax.

4512. A flat rate, yes. I would like to ask you something, and to draw upon your knowledge if we can. Let us forget the actual arguments about replacement costs, how do you say that industry generally stands today now that it has to bear the present system of taxation without allowance for replacement costs and the heavy financial strain involved in the general rise in prices and depreciation of the purchasing power of the pound? Is it possible to give a general view as to the amount of financial strain

on the company that those factors achieve today?—I think that is a question Mr. Bird can answer much better than I can.

4513. I do not expect a complete answer. I do want to draw upon anything which you have in mind or can illustrate for us.—Mr. Bird: I do not think there is any definite evidence that can be adduced in this matter. We have for some decades produced analyses of company accounts, and we have broadened that work since the new Companies Act came into operation. We are in a position to furnish to the Royal Commission, if it thought that it would be of any service to it, a series of "photographs" of the finances of industrial companies, the composition of their balance sheets and the make up of their earnings from, say, 1948 to 1952. But I should be somewhat sceptical nevertheless whether that kind of information really furnished any final answer to those matters, for a variety of reasons. The figures in the accounts with which we have to deal are not necessarily the figures which one wants for this purpose. We have no knowledge of the make up of the assets which are represented by a money figure in the balance sheet. We do not know when they were bought, or when they fall due for replacement, or what the cost of replacing them would be. We can give a more reliable picture of what has been happening to the current finances of industry as a whole, and to groups of industries in particular—such, for example, as the amount of bank finance to which they have had to resort or the changes in the composition of their capital accounts and so on. That information, if it is of any service, can be provided. If one turns to more general impressions, I should say from my observation of company finance that certain companies, and particularly companies which have a larger proportion of current assets than fixed assets, in recent years have undoubtedly been under severe financial strain. One thinks of cases like the Imperial Tobacco Company for example. How companies in the opposite sense, which have a rather larger proportion of fixed assets as distinct from current assets, are faring it is impossible to say. One discovers the truth about that when it is, so to say, too late, when the damage has been done.

4514. Stop there for a moment. Obviously what strain there is must be unequally distributed according to the circumstances of the company. Those whose major interest lies in current assets or in stocks would feel the strain acutely in the course of the last year or two. Those whose interest lies predominantly in fixed assets might easily have such strain as there is deferred over a future period of years?—Yes.

4515. And therefore to generalise even at that stage becomes very difficult. Would you not say also that the actual financial policies which have ruled in the companies in the past are themselves infinitely varied?—The decision whether to plough back or to distribute higher dividends and so on; yes, that would indeed be a factor.

4516. They would have infinitely various records, varying from extreme prudence upwards or downwards?—Surely.

4517. And therefore the income tax and the depreciation of the purchasing power of the pound must be felt very differently from that point of view too?—Yes, I would think that the reactions of industrial companies to the maintenance of their physical capital, and the consequent implications on dividend policy have come into rather greater prominence in the last year or two. My impression was that industry as a whole came out of the war with very severely damaged fixed assets, but with current assets fortified by very considerable accumulations of liquid capital.

4518. Yes, therefore, if you found in the last year or two what I will call a quite large shrinkage of readily available funds, there would be nothing surprising in that in itself, would there?—Not for the companies or industries that had been pursuing, as many have, an active investment policy since the war.

4519. On this sort of thing, as I follow it, you can only make observation after the event when you see what has happened?—So far as fixed assets are concerned I think that is very true; an asset which may last 20 years may still give good service during a time when inadequate provision is being made to replace it, or when no thought is being given to replacing it.

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MR. GEOFFREY CROWTHER AND MR. ROLAND BIRD

[Continued]

4520. Have you a general impression about the situation today envisaged as affecting the future? One has got to consider the ability of industry in general to maintain its volume of production, and also achieve development and improvement.—My general impression is certainly that, given the trend of prices of recent years, and the taxation burden which has gone along with it, there has been inadequate provision not merely for the maintenance of stocks and working capital, but also for the maintenance and the wise expansion of industrial fixed assets. The point which impresses me increasingly is that the major source, in fact virtually the only source, of risk capital going into industry now is the amount that the companies themselves have available to plough back and that is less than it should be in my view.—Mr. Crowther: May I add a word on that. It seems to me that it would be very difficult to point to any concrete evidence yet available, for this reason. I am referring now to fixed assets. We have been living through a period when replacement of fixed assets has been obstructed by any number of difficulties that are familiar, and the question will not be reliably susceptible of determination until the time arrives when fixed assets can be readily replaced in large volume. That may very well be a period of bad trade and low profits, so the question is whether it be possible at that time for companies which have not been allowed to build up their reserves to raise capital in the market in order to replace their fixed assets at the desired rate. One may have a guess as to the answer, but I do not see that anybody can say until that time comes.

4521. Mr. Bird said just now that he thought that the retained profits, at any rate very largely, were the only available source for further financial business. Would you say that is shown by the indication today that capital is not available, invited either through the machinery of public subscription or otherwise? It is a controlled.—Mr. Bird: Yes, Sir, apart from the control, it would be a matter of some difficulty under present conditions to raise considerable amounts of industrial equity capital. It would certainly be a good deal more costly than it was, at any rate; many companies who might have undertaken issues of that kind two or three years ago would, I imagine, think twice before doing so now.

4522. That is on economic grounds alone?—Yes, and the counterpart, of course, is the fact that the private saver, as we used to know it, has virtually disappeared.

4523. The investor?—Yes.

4524. Mr. Millard Tucker: Would you mind telling me in relation to your views about ploughing back, do your observations apply to all companies of whatever size? Do they apply to small private companies?—Mr. Crowther: I am not quite certain that I understand the purport of the question.

4525. You have at some length suggested that there should be discrimination in favour of trading profits which are ploughed back into the business, or have I misunderstood you?—No, Sir, I think that is not quite accurate. The argument was that the present system discriminates against, and that whether or not it would be right to discriminate in favour, most people, we suggested in our evidence, would at least as a general proposition agree that there should be no discrimination against, and therefore we would advocate the removal of what seems to us to be the discrimination against ploughing back of the present system.

4526. You really express no definite view about whether there should be discrimination in favour of it?—Not in the circulated evidence, but I am perfectly willing to give my personal view, which is that there should be some discrimination in favour of ploughing back.

4527. That is what I wanted to ask you. One can understand that in the case of a bigish company which is frequently directed by a Board of Directors who may not themselves have a tremendous stake in the business, they can take a more detached view of the position; but would you make your proposal apply to all kinds of company, big and small, no matter how highly their capital is held?—We are not suggesting, I think, that the provisions of the existing law that enable the Revenue to intervene in the conduct of very closely held private companies should be repealed. I would like to add that one can only get a very general impression of this sort of thing without knowing the circumstances of the cases, but

from the stories one hears that power is not used too oppressively, and might well be continued.

4528. Not at the moment.—I have no doubt that your experience of that is very much greater than mine.

4529. Some traders who were victims of this section in the past might not agree with you. You say, it involves, does it not, some sort of definition as to what is meant by ploughing back?—Our evidence suggested as a rule-of-thumb attempt to deal with the question that the definition of capital employed in the business as used for wartime E.P.T. might serve. Ploughing back is expenditure which increases the capital employed in the business. That definition excluded, if my recollection is correct, additions to purely financial reserves.

4530. It eliminated excess cash and even excess investments?—Yes.

4531. You see, what troubles me about this proposal is how one meets the sort of case where, in the small private company, money is not distributed by way of dividends in order to build up the capital value of the equity holding, and is not really required for the business at all. It is not distributed, because if it were distributed the bulk of it would go to the Inland Revenue. Do you see what I am troubled about?—I do indeed, but would not the two provisions suggested at any rate largely meet it; first of all confining the definition of ploughing back to capital employed in the business, and secondly the continuance of the existing powers for insisting on distribution?

4532. I do not want to make too much criticism about those sort of later powers you refer to, because in some cases they seem to have worked quite well in practice, and in other cases they do not. It is very difficult to explain to a strange body of people what may be in the minds of the Board of Directors of the tightly held private company as to their future plans, or, if you do tell them, to convince them that you really intend to do that and want the money at some time—I think if any income that should be taxable escapes, it is always caught in the end by the death duties.

4533. If this is done in the case of companies which, after all, whatever may be the legal position are nothing but a group of individuals in the end, why should we not extend that right to individuals who are carrying on business?—In principle I should be perfectly ready to.

4534. And to partnerships?—Certainly.

4535. There is a difficulty there.—That is why I said in principle, because I am aware that there are big practical difficulties.

4536. A lot of these proposals are all right until you come to deal with them in practice, they sound awfully good when they are enunciated, but when they come to be applied in practice there are considerable difficulties in defining the scope of the relief one is giving.—I do appreciate that, but hard cases make bad law, and one has felt on occasions that the Revenue is sometimes more reluctant than it should be to agree to proposals, because there would be a small minority of cases where it would lead to the Revenue being cheated. It seems to me that where it is a small minority it is better to take that risk.

4537. I would not like to say that if that proposal is introduced there would be only a small minority taking advantage of it. I should think it would be a small minority who would be found to be operating it in a reasonable manner.—I find it difficult to agree with you. After all there are safeguards which, as you suggested, have been operated almost oppressively in the past, but they do exist. I mean safeguards against the failure to distribute, and I am suggesting another against the building up of purely financial reserves.

4538. Do not misunderstand me about these provisions operating at present; it is not the way they are administered, it is the effect that the law requires once they are administered. That is to say, if one of these companies whose affairs can be scrutinised for this purpose is found to have under-distributed its profits, even to a very small extent, the penalty is that the whole of the profits are taxed, not merely the reasonable part that should have been distributed, and that is where the oppressiveness comes in.—I agree, I did not take the suggestion as being anything else.

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MR. GREGORY CROWTHER AND MR. ROLAND BIRD

[Continued]

4539. On the other hand, it is an awful task to ask a body like the Special Commissioners to decide in each case what would have been a reasonable distribution. Would you mind telling me, if you can do it quite shortly, on what footing does your claim to charge depreciation on replacement costs rest? Is it commercial expediency, in the sense that companies are short of money as a result of the present system, or is it because, in fact, the amount of capital used up during the course of the year should be calculated by reference to the present value of the capital and not its historical cost? Which of the two do you regard as the basis for your suggestions on replacement costs?—I should like Mr. Bird to answer that, but I would like to give you my own answer.

4540. I am addressing you both.—If I gave my own answer I should say that it is both, except that I should use perhaps slightly different words from commercial expediency. I should say that it is a matter of public policy that the capital equipment of industry should be maintained. Our basic reason is that the change suggested would bring the operation of the tax laws into accordance with reality. They are now based on the assumption that money is a substance of immovable value. That is not so in the world as we know it. Money is a substance of very movable value, and the main reason for the change is that it would bring taxation into accordance with reality. I might add to that, one tends to think now of the tendency of prices to rise, but there are times when prices would fall, when no doubt many of the people who are now firm in advocating the calculation of depreciation allowances by reference to replacement cost would change sides. I would like to put myself on record that when that time comes I hope I shall stay on my present side.

4541. As one goes through the various kinds of evidence we get on this point I would like just to get the reason which is underlying the claim. Sometimes they differ, and one person says one thing is the basic reason for his claim, and another person says something different.—My answer is both.

4542. You take both.—Mr. Bird: May I comment on this? I would put much greater emphasis on the second proposition than on the first proposition on these grounds. I think the argument is an economic argument, that the economic resources used in any given period of production ought to be priced at their current cost, and similarly that the output of any given period of production ought to be sold at current cost plus appropriate profit. If the cost of the amount of a fixed asset that is used up in Year 20 is imputed on the basis of lower prices in Year 1 when the particular capital instrument was installed, it follows that consumers will enjoy its contribution to current output at a price that falls adequately to provide for its replacement. The contribution made to the output in any current period of production ought, in my view, to be costed on its current value; that seems to me the fundamental reason why the replacement cost argument is the valid one and the argument for allowing replacement cost in tax computations follows from it.

4543. That is a very useful answer. I have only one more question to clear my own mind about it. Everyone agrees I think that in the ascertainment of the trading profit for the year you must take into account the amount by which your capital has been used up during the course of that year. I think everybody agrees with that as a general principle, but what you say is that in ascertaining that latter figure you will treat yourself as having lost the current value of the particular part of the capital that is used up. That is your view?—That is roughly so.

4544. And that is the basis for your claim, or mainly?—Yes.

4545. Just one other question on your memorandum. In your answer to Question 12 about the taxation of husband and wife, your answer is that:—

"As a matter of equity and also, in the medium and higher ranges of income, of incentive, the earned incomes of husband and wife should not be aggregated."

Do you agree that the unearned income should be aggregated?—Mr. Crowther: Perhaps I might answer that. The difficulty it seems to me is this, that in the case of unearned incomes one can never be sure that the incomes are, in fact, really separate incomes, because it is so easy in most cases to transfer the source of unearned income from husband to wife or from wife to husband as the

case might be. In the case of earned income, though there would no doubt be a small minority of cases in which that would be possible, in the majority it would not be possible and if husband and wife each have an earned income the presumption must be very strongly that they really are separate earned incomes. The reason for the distinction, apart, of course, from the case for giving an incentive, is that in the case of earned incomes there is the presumption that they really are separate; in the case of unearned, though no doubt there are many such cases, it would be extremely difficult to make such a presumption. Of course, it would be open to the State to do as I understand the United States have done and say that even if the separation of incomes is going to lead to evasion in the way that I have indicated we will nevertheless apply it; but that would seem to require as a corollary that the rates of tax must be higher to produce the same revenue. Clearly we cannot afford to do that in this country, therefore one has to draw this distinction and say that in the case of earned incomes it can be done either without any increase in the rates at all, or at any rate a very small increase in the rates of tax to produce the same revenue, while in the case of unearned incomes it could not.

4546. In the case of husband and wife you could overcome that difficulty in the same way that it has been overcome in other fields of the present law by saying that any diversion of income from husband to wife or vice versa should be ignored just as this ignores any diversion of income to an infant child.—Quite so, but would it not be difficult to provide for all cases of gift of capital?—After all there are many perfectly genuine.

4547. That is avoided in the case of infant children, and why should it not be done in the case of husband and wife as well?—It may be, but in drafting would it not be difficult? If you tell me that it would be easy I am delighted.

4548. I wondered whether you were approving, by this answer, of the aggregation at all of husband and wife's income. Do you approve it or do you not?—I find it extremely difficult to answer that yes or no. It creates a great many injustices.

4549. You think there is a case for it and a case against it?—That is so. I think at the time when the structure of British income tax grew up the case for aggregation was no doubt very strong. But as society moves on and as women's incomes change their character, and one might also add as the marriage tie is weakened, then perhaps the case for aggregation is weakened. Whether it has got to the point that the balance of the argument is on the other side I would not like to say.

4550. One last question. I am not going to ask you detailed questions about it, but it is to get your view because our colleague, Mr. Kaldor, is not here today and so is unable to question you about it. Is it your view that, if it could be done properly from a practical point of view, a tax on expenditure is preferable to a tax on income?—I think as a matter of theory it is extremely attractive, most particularly because it gets over a dilemma that many people, including myself, feel very strongly about, namely, that whereas it is in the public interest to encourage savings (which leads logically to the conclusion that one must be tender to the large incomes that produce the large savings) the spirit of the age is very much against lavish expenditure. So in principle, as a matter of theory, I have always liked this idea very much. At the same time one is completely defeated by the task of discovering some way in which it could practically be done. My thinking has never got beyond that point, that it is something very nice, but I cannot see any way of doing it.

4551. If it could be done you would prefer it, would you? We have it to a certain extent in the purchase tax.—I think so, or at any rate I like the principle. I do not say it should dominate the taxation system, but it should be largely represented in it.

4552. We have it in the tobacco tax in effect. This is the last question, would you say that expenditure tax is more inflationary than our income tax, or perhaps you have not had time to think that out?—Just at first sight I should say that it would be less inflationary, but on further thought I might alter that.

1 August, 1952]

MR. GHOSEY CROWTHER AND MR. ROLAND BIRD

[Continued]

4553. *Miss Sutherland*: I have just a few points I want to ask. I am very much attracted by your proposal for the universal personal income tax and the graduated surtax, but there do seem to be some difficulties. Would it not be rather difficult to have this surtax beginning at £600 per annum which would mean that a great many people who at present enjoy P.A.Y.E. would be completely out of it? It would bring an enormous number of people out of the P.A.Y.E. category who are now very accustomed to it, and the evidence we have is that they very much appreciate the P.A.Y.E. system.—Not strictly speaking, no. The first of our suggested taxes, resulting from a tripartite division, would be deducted at the source and therefore in a sense replace P.A.Y.E. As for the figure of £600, that is only by way of illustration. I would not like to be held to that, but if the figure were in that neighbourhood one would only be restoring, broadly speaking, the position as it existed before the war, that is to say, the number of people who would be assessed to taxation individually and taxed only after the assessment would only be roughly of the same order of magnitude as it was before the war. Indeed, as compared with the pre-war position, there would be an advantage for everybody in that they would pay some of their tax at source, and the payment after assessment would only apply to the remainder.

4554. I should have thought the lower rate of taxpayer of before the war was P.A.Y.E. as an enormous social benefit owing to his difficulty of coping with payments, particularly, of course, if their incomes are unstable.—That is so, and the idea is that the great mass of the smaller incomes should be excluded from the separate tax. The figure of £600, I think, was put on paper about a year ago and you might have to revise it already.

4555. You were thinking of something possibly rather higher on the whole?—Yes.

4556. Then the other thing about the ungraduated or flat rate tax, individual personal income tax, you would be inclined to the view that it would be a good idea for every person earning money, or having money, to pay it, but to have some allowance offset against it which might, in a great number of cases, exclude them altogether?—Yes.

4557. You would not agree with some evidence which we have heard which suggests that as the amount you get from taxation on the lower income levels is very little it would be worth while knocking them out altogether?—No, I would not. It seems to me a valuable social principle that everybody should pay, or at any rate think he is paying, something.

4558. And then the psychological point might arise that those who are not at present income tax payers, although they would get it back, would feel that they were subject to tax, and it would be rather unpopular. You do not feel quite the same about something you get back on a ticket when something is deducted at source.—All taxes are, of course, unpopular. I do not think it would be more unpopular than anything else. I think it would have a better effect on incomes. After all taxation on the lowest slice of income is not a disincorporative; most of us have to have some income. But if the proposed system meant that the burden of tax appeared to be, or was, reduced on the marginal level of income then that would be an advantage.

4559. I should have thought it might be a political difficulty to introduce a general income tax bringing in such a number of people who have been excluded when the tendency has been after all to exclude increasing numbers.—We have not thought it our duty to consider the political difficulties throughout this memorandum. So many other people do consider them that we thought perhaps we should not.

4560. About this question of husband and wife, I suppose one of the difficulties about this question of their joint assessment is the fact that at the lower income levels the present arrangement is more profitable to husband and wife whereas at the higher level it is less profitable?—That is because within a system that still clings to the principle of aggregation arrangements have been made, where there are two small incomes in the family, which in effect achieve the result of separating them. In fact, the State, without departing from the principle, has had to raise the force of the argument for separation for the lower incomes.

4561. *Mrs. Anney*: I should like to ask you if you would elaborate somewhat what you said in reply to Question 2 in the second document on your "Answers to list of economic questions", where you are speaking about the possibility of introducing an annual tax assessed on the basis of personal capital. I can imagine that you think this is less attractive than an expenditure tax if an expenditure tax could be made practicable. I think you believe that it would be very difficult to make such a tax practicable and you think that it would be very difficult to levy a tax on capital gains. I just wanted to ask you whether, if those two types of tax were rejected, the expenditure tax, or the tax on capital gains, there is not something to be said for an annual tax on the basis of personal capital even if it were additional to the income tax in order to try and secure revenue from those who are favoured by the possession of capital means as opposed to those who have only, let us say, earned income?—Yes, there are a number of aspects in this matter. I am not quite sure which is the one....

4562. I really wanted to know what your views were, because you put it very shortly, and I wondered whether you thought there was anything to be said for it or what were your grounds for saying on balance no.—I am not quite sure whether the question is, should the present burden of taxation on unearned incomes be higher than it is, or should that burden be assessed in some different way. Perhaps I could answer both. In the first place, though this is not an economist's judgment, because I do not think that the principles of economics give one any guidance on this, it is an expression of personal political judgment. I would say that the burden of taxation on unearned incomes is now high enough. There is the distinction in the income tax which itself is very high. There is also, as so often is forgotten, the long-stop of death duties which are also levied on the capital that provides unearned income. So my answer would be that I would not advocate any increase in the present burden of taxation on unearned incomes, though I suppose if in my next breath I say that as much of any reduction of taxation as possible should be given to earned incomes I am arguing for an increase in the differential between earned and unearned income.

As for the method of assessing the burden, I can see one argument for assessing it not on the income from capital but on the capital itself, and that is that it would provide an incentive to investing capital in the more remunerative ways which must on balance be best for the community. On the other hand I can see two difficulties, firstly the practical one, how do you assess capital? In so many cases capital value is merely the income produced multiplied by some factor created by the community's ideas at the moment about the rate of interest. We have had a striking demonstration of that in the last 12 months when the capital value of gilt-edged securities has come tumbling down. Would it be just, I ask myself, because of that fact, and that fact only, that those who enjoy income from their gilt-edged securities should have their taxation reduced, to which I give the answer "no", it would not be just. Secondly it is all very well to say that this would be in replacement of the existing taxes upon capital. In fact, it would not be, it would be an additional tax, and so I am led back to my first answer. I think my answer is in the negative to both aspects of the question.

4563. I also want to ask you to expand somewhat, if you will, what you said in answer to question 1 of that document where you talk about the practical limitations to the economic argument in favour of using taxation as an instrument of monetary policy. The first one is the reason that in spite of the best intentions, the result will be permanent deficit financing. Why should that be so?—I am afraid that is merely a political judgment, shall I say, a judgment of politicians.

4564. It is political?—Certainly.

4565. I could not quite follow why that should be so.—It is merely an expression of belief that that is, in fact, what would tend to happen.

4566. *Mr. Crick*: You will not mind I am sure if I jump about somewhat from point to point, and I would like to begin at this old, old question of replacement cost. It arises out of something you said in answer to a question, namely, as I understood it, that you advocated replacement cost as a basis of depreciation allowances, fundamentally

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because it would bring the tax system into accordance with reality, and principally the reality of the variability of the value of the money. That is the basis in principle. Would you be disposed to extend that principle to other features of the tax system such as the personal allowances and the steps in graduation?—If I understand the question correctly, yes, certainly; that is to say that the figures laid down in the Finance Acts for the personal allowances and the steps in graduation should be altered frequently in view of the changes in the value of money.

4567. Would you make that automatic or dependent upon stages? Would you define the allowances as being so much money plus or minus a multiplied according to a given index number?—That is a little bit more difficult to say. One sees the force of logic behind the suggestion, but it might be, not difficult, but absurd if it led to very small changes being made very frequently. If we are going to have such large changes in the value of money as we have had in recent years perhaps there would be a great deal to be said for it, but one continues to cherish the hope that some day we shall come to a period when money is, not stable, but when it does not move quite as fast as it has been moving recently, and in those circumstances I think a plan that led to the children's allowance being altered by 10s. now and then would be almost ridiculous.

4568. If you had some considerable flexibility, limited so as to get rid of that difficulty you are foreseeing, it would follow, would it not, that in a time of inflation your revenue would be less than it would have been under present conditions?—That would depend on what happened to the standard rate, or whatever took its place.

4569. The standard rate we assume is an annual affair, and naturally the effect of the application of your principle would be as I have defined it, would it not?—I am not sure that I follow, I take it that these changes in the allowances would not be made more frequently than annually. Therefore the Chancellor of the Exchequer in framing his Budget would make some estimate of what these allowances were going to be in the forthcoming year. No doubt he might wish to change them as he frequently does and on the basis of these changes he would decide what the rates of taxation were to be.

4570. It would bring a new element into his estimation?—Yes.

4571. A new uncertain factor?—Certainly.

4572. Do you think that would fortify or strengthen his hand against the forces of inflation or not?—I find it very hard to express a judgment on that. So much would depend upon the circumstances at the time. These allowances after all are really devices for distributing the burden of taxation between taxpayers of different personal circumstances. To make them move with the value of money might be inflationary at some times and deflationary at others. I find it difficult to generalise.

4573. I have in mind particularly the relations of the Chancellor with his colleagues, the heads of the spending departments. Do you think it would have any effect upon those relationships?—His relationships with the heads of spending departments are already affected by variations in the value of money. When prices rise no doubt he is subjected to demands for more money from the spending departments. I cannot see that it would alter the matter in principle if on the other side his revenue were also affected, as indeed it already is.

4574. I had in mind the possibility that at the same time as increasing demands for money were falling upon him he would be able to point to the probability of a shortfall of revenue by reason of these flexible allowances. —Yes, he would have to show a prospective decrease: that is it would not be a decrease, if we are talking about a period of inflation, but a smaller increase in revenue, the rates being left where they are.

4575. You make quite clear your position on dependent allowances with regard to fixed assets. I did not find clearly in my mind what your opinion was as to the treatment of stocks?—I must confess, perhaps I should say that for this second document only I am responsible. Mr. Bird was absent when it was written, I have to confess when I read it through last night I was not very sure what I had meant myself by that, that is to say, I was not sure how far it was fair to put the blame

upon the taxation system as distinct from accountancy practice. One knows as a matter of general observation that in times of rising prices companies which have to carry large quantities of stocks and raw materials and the like do show, and are taxed upon, very high figures of profits, whereas in periods of falling prices the opposite occurs. That has always seemed to me, from an economic point of view, to be unfortunate. It leads to over-optimism at times when optimism is dangerous, and to over-pessimism at times when pessimism is dangerous. But how far one can blame the system of taxation for that, and how far the determination of accountants to do everything in money form, I am not sure that I should like to say.

4576. You are not mentally wedded to any particular form of treatment of that problem?—No.

4577. As to company taxation, as I understand it, you would get rid of the levying of the standard rate of income tax on profits not distributed; you would also get rid of the profits tax altogether, and you would not have the E.P.L. You would substitute for all those things what you might call a corporation income tax. Could you give us any idea of the pattern of that tax? I am not thinking at the moment of the basis of computation of profits, putting that aside, but have you in mind, for instance, a flat percentage tax or a graduated rate, and if so what is the basis of graduation? What, in other words, is the general pattern of the tax you have in mind to levy upon companies' profits?—I have always thought that it should be a flat proportional rate of tax. I know that in the United States, where they have a corporation profits tax, it does now have an embryonic form of graduation, which is I think due to the great congressional liking for the small business, but it is a very minor graduation and seems to me to be very wrong in principle. I should say a flat proportional rate.

4578. Would you make any discrimination in the rates between profits distributed as dividends and undistributed?—This particular proposal is for a rate of tax that would apply only to profits that were not distributed. If they are distributed then they should be regarded as income in the hands of the individual recipient and taxed as such.

4579. Does it mean that you would levy no tax at all on profits ploughed back, retained in the business?—No, but I would levy a rate of tax, that is to say, the general burden of taxation being what it is now, I would levy a rate of tax below the present standard rate.

4580. You would still have your deduction at source on the amount distributed as dividends?—Certainly.

4581. Over and above the flat rate of profits tax?—No, not over and above. The suggestion is that that portion of a company's profits which is distributed should be taxed as income in the hands of the recipient, and, as I said in answer to the Chairman, it might well be administratively convenient to make a first slab at that by deducting tax at some rate before it is payable, then for lower adjustment with the Inspector.

4582. Chairman: If you did that it comes to the fact that you are doing the transaction through as agent, you are taking from the agent and the company would be handing over, from what it deducted, to the Revenue. That is so, and the rest of the profits, that is to say the portion which is not distributed, should not be taxed as at present at the standard rate, but at some other rate. I think it would perhaps be easier to say that I do not conceive of these as being different taxes from the present, but a different structure of rates within the existing tax.

4583. Mr. Clerk: I would be very grateful, and I think some of my colleagues would be, if you and Mr. Bird would work out a few hypothetical examples. I confess I am still not quite clear what you are advocating, but if you could give us one or two handy little examples of how you would levy the tax compared with the tax as it would now fall, I think that would help us a great deal. Now you would foresee that as a result of that and other changes you recommend the revenue would suffer on balance, and I gather that you are disposed to recoup that shortfall of revenue by increasing the taxation on unearned incomes?—No, I do not think that is strictly accurate. It is my view that within the present

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burden of taxation too much of it rests upon the undistributed profits of companies. It therefore naturally follows that if that part of income is to be relieved in part of taxation, some other parts must be increased, but I do not think it is right to say that we pick out unearned income for it.

4584. I may have misunderstood you.—I think it has just occurred to me what was in your mind. That was a suggestion in our evidence that profits tax should be abolished, and the revenue now provided by profits tax recouped by widening the spread between earned and unearned income in the income tax. But that would not lead to a net additional burden upon unearned income. It would merely be a different way of levying it. Instead of being upon that portion of unearned income which is at present affected by profits tax it would be on the whole of unearned income.

4585. I would like to mention one or two miscellaneous points on which I would like clarification. In paragraph 2 of your document, item (iii), the second part of that item, you mention a difficulty which must be recognised and I wondered if you really had any practical suggestion for overcoming that difficulty.—If the universal flat-rate tax were levied upon a weekly or monthly basis, that is to say as salaries and wages are paid, then it seems to me there would be no difficulty in changing the rates at any time. It has happened once or twice within the last two decades or so that it has been necessary as a matter of public policy to change the rate of income tax in the middle of a year, and it has always given rise to the most complicated adjustments.

4586. That would be an additional factor in your case for a simple tax?—That is so.

4587. On this simple tax I wanted to ask you this point. You would I think agree that while you might gain a great deal administratively along that line you would, would you not, lose a good deal in terms of equity, in the sense of fairness?—I do not think so. If you took the tax by itself, no doubt it would, but if coupled with the other proposal for a system of allowances assessed as a separate operation, but in practice set off against taxation, I think not. They could be so arranged as to provide any progression that you wish.

4588. The individual would feel that justice was being done between him and the next man just as readily as he feels it on P.A.Y.E.—I would prefer to put it in the negative. I see no reason why he should feel that more injustice is being done than he feels at present. I think it is a general observation that the ordinary man has not the faintest idea how his P.A.Y.E. is calculated.

4589. But nevertheless does he not, in your experience, feel that on the whole it operates pretty fairly?—I should hesitate to say either that or the contrary, from my experience; he accepts it as something that has to be borne.

4590. On the question of a simple tax, you suggest it should be collected by deduction at source, and I think in answer to a question earlier on you said: "This should be done in all cases". Are there not many cases in which it would be quite impracticable?—What I said, if I may correct you, is "wherever possible", that is to say, in at least as many cases as income tax is now collected at source.

4591. Is there not a large area where it would not be possible?—There is a large area where it is not done at present. One is always told it is not possible. I would not like to express my opinion.

4592. There is a large area where it is not done at present, but that area would be surely very much larger when you want to collect tax for the first pound?—I would not think so, with respect. I can see no difference.

4593. Surely there are a large number of incomes which are not traced under present conditions, because the assumption is they are too small to be bothered about for tax purposes?—Is it still true there are a large number of such? One hears, for example, that railway porters are now assessed for income tax, and an assumption is made as to their earnings from tips, and other such cases. Is it still true there are large numbers of incomes that are not traced?

4594. I should have thought there were a large number of smaller traders who were taken no notice of because the assumption was that their income was so small. If that be so, it follows, does it not, that the escape will be far larger when you want to tax income down to a lower level?—I am not sure that the reason for not trying to trace them is that they are too small, because one notices where it is possible to catch a man the Revenue will go to very great lengths to catch him. I spent the best part of a day recently trying to get clear with the collector and the inspector amounts of tax which in the aggregate, over a period of six months, only amounted to a few shillings on my wife's charwoman, so the smallness of income is apparently no deterrent. Why the small trader is not brought in is because he is too difficult to catch, and if that is so the position would remain, under the tax I propose, as at present.

4595. In paragraph 2, in item (v) you speak of what you describe as the inequity of granting no relief for those who save the State expenditure by contracting out of one or more of the welfare services, and later on you apply this more especially to education. I want to question with you whether there really is inequity here, seeing that the service is available to all, although it is open to the citizen to contract out; why should he be given, so to speak, a bonus or a let-off in respect of tax because he chooses quite voluntarily to incur expenditure on a service which otherwise would be obtainable from the State?—I will admit to you very readily that there can be very different opinions on this matter. It is a matter of opinion, but I should draw quite a distinction between two cases that one can imagine: one, where the service was available, and the fact that certain members of the community did not use it made no perceptible difference to the cost of running that service. In that case I should say clearly there should be no concession to anybody who contracted out. The other case, which is I think that of the national educational system, is one where it does make quite a difference to the expenditure the State incurs upon education, that some portion of the community does not choose to avail itself of it. In those circumstances it does seem to my mind to be an inequity, that a citizen who saves the State money should be given back no part of that saving.

4596. On the argument you put forward as to the expenditure side of the business, would not the case be very much stronger in respect of the medical services? Would you, for instance, advocate that if I chose to employ a private dentist I should receive some tax relief on that?—By mentioning education I did not mean to exclude the health services.

4597. You would advocate a tax allowance in respect of the non-use of State health services?—Certainly.

4598. Can you see any difference in logic between that particular concession and the argument that it is all wrong that because I smoke I pay very much more to the Revenue than you do so, I believe, a non-smoker? Your reply to me would at once be: "But the remedy is in your own hands", as indeed it is. Now is not that a precise parallel with the condition under which you are claiming relief in respect of the social services? The remedy is in your own hands, surely?—I can see some analogy. I think I should quarrel with the words "precise parallel" which you used. There is a certain theoretical incompleteness in the philosophy of indirect taxation. The argument is that everybody is caught by one or other of these taxes, therefore in the end it works out all right. No doubt there are people who neither smoke nor drink, nor buy anything very much that is subject to purchase tax, they must be very, very few. It is perfectly true I do not smoke. I confess I do consume alcohol, though others I think do not, so perhaps in the end it does not work out to be so inequitable.

4599. In paragraph 10 you make the statement that the present rates on the higher earned incomes have long since passed the point of diminishing returns. I wonder what the evidence is for that statement?—I was rather afraid somebody would ask me to produce proof of that. Of course, it cannot be proved, but I am absolutely certain it is true. The only evidence I can give is my own case, because it has certainly long passed the point of diminishing returns in my case, that is to say, indolent though I am, I should not refuse such small opportunities as come my way of earning a few extra guineas if I did

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not know that what would stick to my fingers in the end was really such a negligible portion of it. My own case certainly works that way. One knows from general observation that there are many other people in the same position.

4600. You are thinking more particularly of people in the higher income levels?—I would hesitate to put myself there, but still I say in the same class.

4601. One general question arising out of your other document, your personal document and not the dual document. Mrs. Asquith asked you a question about the practical limitations upon the use of taxation for monetary purposes. You feared the result would be permanent deficit financing. I understand your reason for making that statement was what you described as political judgment, and you reached that conclusion, as you say in your paper, notwithstanding experience of the past four years. Just what do you mean by political judgment in that context? Is it in your mind that there is more likely to be occasion for securing deficit financing on economic grounds than there are likely to be occasions for defending high taxation for disinflationary purposes?—No. It is not so much that as the belief that once you depart from the principle, which was very clearly enshrined in the country right up to the war, that the job of the Chancellor of the Exchequer is to cover the expenditure, neither more nor less—once you depart from that principle and say that the relationship between the revenue to be raised and the expenditure to be met is one for judgment at the moment, it seems to me to be more likely than not that that judgment will lead on the whole to be exercised in a way that will lead to deficits rather than to surpluses.

4602. Coupled with that I suppose you would see some disciplinary effect in the notion of an annual budget?—Yes.

4603. Then you also say in that same paragraph that your own judgment suggests to you that the use of taxation for these purposes, that is, broad economic purposes, could go very much further than has hitherto been attempted. I wonder if you care to give examples to illustrate the kind of way in which you think taxation might have been used in the past with advantage, but has not?—Yes. It is, shall I say, the accepted doctrine of the moment that economic fluctuations are closely connected with, and indeed caused by, changes in the rate at which income is saved and converted into capital. It has always seemed to me that the taxation weapon could be used much more than anybody has ever attempted to use it, to modify the time incidence of capital expenditure in a way that would help public policy. In fact, in one paragraph I suggested a way in which that might conceivably be done; that is to say, at times when the State needs more capital expenditure by industry a tax concession could be given to stimulate it, and conversely at times when capital investment should be held back it should be made expensive, in terms of taxation, to spend money in that way. That is the most important example that occurs to my mind.

4604. You have in mind the kind of thing that might happen with a flexible initial allowance?—Yes. Not being an accountant, I have never been quite satisfied that the initial allowance was the way to do it.

4605. But on the whole, as the kind of thing you have in mind, you would commend the recent suspension of initial allowances?—Yes, if I can make the reservation that to give an initial allowance as large as 40 per cent., and then from one day to the next cancel it completely, seems to me rather an abrupt change.

4606. Mr. Cunningham: When answering Mr. Crick, I gather you doubted whether this overall tax that you refer to in paragraph 4 (a) in the first document, that is, the universal personal income tax, would bring in a lot of people who are not the subject of assessment at the moment. Do I gather that right, or have I misunderstood you?—I am not sure that I caught exactly what it was you were asking.

4607. I gathered from your answer to Mr. Crick that you thought that the vast majority of people in this country, the working population, are already subject to income tax, and that your universal personal tax would not involve much more work because it would not bring in large numbers of people who had not already been subject to income tax?—I should say the great majority of people

in this country are within the purview of income tax. Whether in fact they pay any or not is a different matter, but they do not escape the attention of the Revenue.

4608. I have just been looking at the annual report* of the Commissioners of Inland Revenue for the year ending 31st March, 1951. It says here that for that year the estimated number of individuals with total incomes above the exemption limit was 20,150,000, and of those 5,100,000 were entirely relieved from tax by the operation of allowances.—That is a different point from the one I was discussing in answer to Mr. Crick's questions, as I understood them. He was asking me, if I understood him right, about the people who at present escape attention altogether. Of that five million the great majority, one must suppose, are employed persons, whose wages are known to their employers and could be brought within the purview of a tax with no more trouble to the employer than he already takes. The fact that five million people do not pay tax does not mean that five million incomes are not considered as to whether they should pay tax. In fact I fancy the small traders Mr. Crick was referring to are not included in that five million because the Inland Revenue does not know about them and therefore cannot put them in the figures.

4609. I was coming to the small trader. That subject was referred to in paragraph 14 of the Report of the Committee on the Taxation of Trading Profits, where this is stated: "We understand the number of businesses at present within the scope of Cases I and II of Schedule D is about 1,950,000. Of these, 450,000 are persons whose total incomes are too low to make them liable to tax, and who are not therefore brought into assessment."

—With respect, that still is not quite the point I was discussing with Mr. Crick, because the mere fact that they have been counted shows that they are known. He was talking, as I understand it, of the people whose existence is not known to the Revenue.

4610. That is rather a different point.—Precisely.

4611. I would think that the only ones who would come into that are those who, to use a police expression, have no fixed abode, or those who have a dual life and work in a shop in the daytime and do some house painting over the weekend, or some harvesting, which does not come within the purview of P.A.Y.E.—That is so.

4612. How would you get at those, the man who does a secondary job over the weekend, or takes some harvesting work in his spare time?—I know of no practical means by which you can get them, but if you did not get them at any rate the position would be no worse than it is now.

4613. I am inclined to agree with you there. Would you kindly elucidate for me, or amplify, what you mean by the next to the last sentence of your answer to Question 3, in the second document? The words are: "If traders were allowed to make long-period agreements with the Revenue to reckon depreciation on a money-value or a real-value basis, then there would be an analogy."—My thought was simply this: the question was asked, if depreciation allowances are to be reckoned on a basis that takes into account the variations in the value of money, why not then debenture interest, and my answer was that a debenture is a bargain freely entered into between parties who must be considered to have understood the terms of it. If I was arguing, the matter of the basis on which depreciation allowances were made were similarly a bargain freely entered into between the taxpayer and the Revenue, then one could say there was a close analogy, and, as the man who has lent money on a debenture is held to that contract when money goes against him, so similarly the taxpayer could be held to the bargain when circumstances were against him. But to compare a free bargain between two parties who have chosen the terms, and a system imposed upon the taxpayer by law, seemed to me to be not an analogy.

4614. I gather from that answer that you would not agree with the line of Professor Posh when he gave evidence before us, that debentures and fixed preference capital should be regarded as negative fixed assets for

* Cmd. 8036, Table 21.

† Cmd. 8109.

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the purpose of calculating allowances on fixed assets?—I am afraid I have not read the transcript of his evidence, nor have I thought deeply about that. I would not like to express an opinion.

4615. What are your views about stock? You did say earlier on that they were not particularly clearly expressed in this second document. Would you mind telling me what your views are about stock?—I am afraid my answer was that they were not very clear in my head, which may explain why they were not very clearly expounded. The general principle that is in my mind is this, that if it were possible to devise a system by which profits arising simply from the rise in the price of stocks held were not brought into profits as taxed, or indeed profits as deducted and distributed in dividends, if they were not regarded as profits at all but carried to some special sort of reserve, and similarly in the reverse, if it were possible in the case of losses arising from falls in the value of stocks not to regard that as a loss but to take it out of reserve, that would seem to me to be a valuable stabilising factor in the economy. But my knowledge does not extend far enough to enable me to tell how far the present, and as it seems to me harmful, practice of reckoning them all in profits as declared in the newspapers and as taxed, in the one case, and as losses in the other, how far that arises out of accountancy practice or is imposed by taxation law.

4616. Have you studied the American system which is known as the elective system?—No, I am vaguely aware of it but I have not studied it.—Mr. Bird: I have looked at that, but not in very great detail, I confess.

4617. Do you regard it favourably?—I regard the offer of the option as being a good thing.

4618. You bear in mind that with the present form of American legislation if you elected to go on that basis you would have to stay on it, even though the market value goes below your L.I.F.O. valuation?—Yes. Of course, there are some people who think the fate of the value of money is to be continually declining, and perhaps an option on that footing is as good as on the other.

4619. Would the textile trade agree with that view?—They would not in the last year, certainly.

4620. What is your view, when the market value drops below the L.I.F.O. value?—What option should then be offered to the taxpayer?

4621. Should they go back to market value?—I think in practical terms it is very difficult to allow any taxpayer to back the winner in all economic circumstances; in fact it would be inequitable for the rest of the taxpayers.

4622. Some of our witnesses have suggested he should have that option.—I think he would be lucky enough if he gets the first one.

4623. I want your view as a matter of principle.—I think as a matter of principle the option should be available to him and, having made his choice, he should live with it, just as a farmer lives with a hard basis or otherwise for his cattle.

4624. Thank you. The next point I wanted to mention arises out of the taxation of husband and wife, the answer to Question 12 in the first paper. As previously stated, you favour non-aggregation so far as earned income is concerned, you say that this reform would inevitably be expensive. Is that right? I do not want to take advantage of you on this, but this point is at the back of my mind, that where the combined income does not exceed £2,000 per annum, and both incomes are earned incomes, the present basis, with the special allowances for wife's earned income relief and the like, gives the married taxpayers an advantage over two single persons?—Mr. Crowther: Yes.

4625. So you have the benefit in effect of non-aggregation up to a combined income of £2,000. The rules are complicated, but that is the result of them. Now would you say that there were many cases, taking the country at large, where the combined earned income would be more than £2,000 and a wife's earnings would be a material element in that?—No, I do not think there would be many. I think the phrase "would inevitably be expensive" was meant as would inevitably cost something to the Revenue, that it is not a reform which can be made without cost to the Revenue.

4626. I read that as being expensive because you thought it would be a material cost on the Exchequer, and I rather questioned that, if you are confining it to income tax.—The actual phrase, it is at the beginning of the answer, is: "This is another area where reform would inevitably be expensive", and I think the meaning to be conveyed there was, if the whole principle of aggregation were abandoned that would bring a material loss to the Revenue. Later on the partial suggestion is made that earned income only should be separated, and the partial suggestion is made at least partly because that would be less expensive than complete reform.

4627. And it would not be a very wide field, would it?—One can only speak from one's general knowledge, I would not have thought very wide, no.

4628. I would just like to refer back to your paragraph 3 (c) in the first document: "What is more, a steadily growing proportion of the 'institutional' savers pay tax at less than the standard rate, since life insurance funds pay at 7s. 6d. in the £ and pension funds pay no tax at all". You are not suggesting, are you, that the present exemption in favour of the investment of pension funds should be withdrawn?—No.

4629. I just wanted to get that clear, because it is a matter in which we are concerned.—No.

4630. Sir Geoffrey Heyworth: Firstly, a question on a very general point. In the first paper you point out that with taxation at the present time requiring some 40 per cent, or possibly more of the nation's income, it has very damaging effects on things like incentive, risk-bearing and thrift. I want to ask you now a question in a sense outside our terms of reference, though it may help to clear my mind a little. Would you say that if the conditions remain that it is not really practicable to reduce the burden of national expenditure so that it would materially reduce this 40 per cent. figure, you would then favour, in order to give you the necessary freedom to deal with these incentives, a revision of our approach to taxation altogether; that is to say, raise more by indirect taxation, such as a direct sales tax, to bring the amount we have for income tax down to a level that would give you greater freedom. I assume, of course, that if you did collect more money in the form of indirect taxation the wage level would have to be adjusted to meet that point. Having made it as complicated for you as that, would you like to express an opinion as to whether that is really underlying what you mean in this first paragraph?—I am glad you have given me a means of escape in your last words, because I can say it certainly was not underlying what was written in that evidence. The thought there was simply that the general disincentive effects of heavy taxation are, in my opinion, much greater than any particular disincentives that may arise from the special form that taxation takes, therefore any improvements you can make by shuffling about within the present rate of taxation are only going to be a minor contribution to the solution of that problem.

4631. So if you really wanted to tackle this problem further, you would have to re-examine this whole incidence of taxation?—Once again, there is no harm in agreeing that we should re-examine.

4632. We cannot really do much by juggling, therefore if you focus the amount of importance on disincentives, it means we shall have to look somewhere else?—Yes. The difficulty is to know where else to look. The incidence of direct taxation is very heavy, but of course so is the incidence of indirect taxation, and the only area you could go for would be indirect taxation upon food and certain services, which are the only things which are not already taxed about as heavily as one can see them being taxed. That is a very large and dangerous question. If you will allow me to dodge it, I prefer to.

4633. In paragraph 1 (i) you deal with the large jumps in the rate of tax collected from wages under F.A.Y.E., which you say appear to exert some disincentive effect, and you say: "... in our opinion the main causes of the present relative lack of incentive among wage-earners are to be sought elsewhere than in taxation." Would you like to say what you have in mind there?—Briefly I should say that the general lack of incentive which one observes in the country today among wage-earners is to be explained mainly by the mere existence of full employment, by which I am not intending to pre-judge the whole argument

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about full employment, but it does, it seems to me, among its many other effects have that one, that it reduces the incentive to effort and to enterprise. Secondly, I have always held that the existence of subsidies upon food and upon rents, and rent restrictions, have that effect. Generally speaking the effect of our present system of heavily subsidising some things and heavily taxing all others is that it is fairly easy for a man to get to the position in which he can meet the primary necessities of his life, and beyond that everything is so heavily taxed that he has to make a very great deal of effort to get a far smaller return. For this reason, there is, in general, although it is not a thing of which any evidence can be produced, there is a tendency to reduce the incentive to effort beyond a point of income which is very quickly reached.

4634. That is again leading us in this direction, that if these things are important, and I think these questions of risk-bearing, and all those things are important, that you as a citizen are not entitled to look to this Commission as an answer to your questions? As you have just pointed out, there are many other things that come into this whole picture.—I think the greatest contribution this Commission can make to the problem of incentive to the wage-earner would still be a small one.

4635. *Sir Harry Gill:* In answer to a question dealing with the ploughing back of profits, it appeared to be assumed that that money so ploughed back would be used for either extending or expanding the business itself, but surely money ploughed back is used in other ways? Would you confine the preferential rate merely to that proportion of it which was used in expanding the business?—Broadly speaking, yes. I agreed with all the difficulties of definition, but suggested that there is a definition in existence which could be used for that purpose.

4636. On occasion bonus shares are issued, the face value of the share is written up, and so forth, out of ploughed back profits. How would you deal with those profits which originally had a preferential rate of tax, when they were used for this other purpose?—*Mr. Bird:* May I say, if the profits have been ploughed back then they are compensated on the other side of the balance sheet by investment in an asset. The particular form that the entry on the liability side of the balance sheet takes, whether it is a reserve, free or specific, or whether it results in an expansion of capital, does not affect the point of how the profits ploughed back have been applied in the purpose of the business.

4637. So that on all ploughed back profits, however they were eventually used, you would favour having this preferential rate?—There is, even in the shortest view, no escaping the simple accounting truth, if I understand accountancy aright, that when a profit is made and reserved in the business, then the resources which are released by that profit are applied in the business.

4638. But surely from time to time people receive an intimation, if they are lucky, and read it in the newspaper if they are not so lucky, that out of reserves there is to be one new share issued for each two held. That reserve has only suffered some preferential rate of tax.—Is not the danger to be apprehended the opposite danger, that some reduction may be made in the issued share capital, some repayment of capital offered to the shareholders, and not an increase in the number of pieces of paper that they hold?

4639. I am not knowledgeable on that, but I should say the other experience is far greater. I think I have got your answer, that irrespective of how that ploughed back capital may eventually be used, for share bonus or any other purpose, you would still favour its having the preferential rate?—*May I repeat my view that the resources that correspond to the ploughed back profits go into the business? They cannot help doing so. Whether they are wisely used or not is a matter of the management of the business and not, it seems to me, the way in which the capital of the business appears to be arranged at particular moments of time.—Mr. Crowther:* May I add a footnote on the phrase "preferential rate"? It is the essence of our argument that the rate should not be a preferential one, but that the present discrimination, as it seems to us, against savings, should be removed. The profits ploughed back should not continue, as they are now, to be taxed more heavily than other forms of savings.

4640. Take the present rate of 9s. 6d., would the ploughed back profits under your scheme be taxed at 9s. 6d.?—No, at less than 9s. 6d., but very few individuals pay tax on their whole income at 9s. 6d.

4641. In answer to question 3, when the point was put as to whether you thought the present method of computing trading profits should be modified so as to take into account the change in the value of money, I think both from the answer which is given in the document and the answers which have been given this morning it is perfectly clear that you favour that course?—That is so.

4642. And I think it was Mr. Bird who gave a very clear definition to me of what he had in mind. He said: "Whatever change there may be in money values, capital as represented by machinery or stocks should be maintained at its current value." I think those words put the position very clearly, but I would like to ask Mr. Bird why this change in money value should only apply so far as the machinery and stocks are concerned?—*Mr. Bird:* Those words indeed are a very loose description of what should be said. All industrial equipment, whether fixed or flowing, must be maintained before a profit can be said to be made in any true economic sense; and since the arbitrary changes in the value of money result in arbitrary distortion of profits as computed by normal accounting methods, the argument, as it seems to me, is that one should look behind the money profits as disclosed by normal accounting methods to see whether in fact the proper provision has been made for maintaining all fixed capital and work in progress and stocks intact.

4643. Physically they are intact. We are talking about the change in money values, and in the answer to the question you bring out very clearly, you brought it out in the document and you brought it out in your answers this morning, that when the question of debentures is raised you say that there is no analogy, but surely the change in money values applies equally to the debenture in its financial effect as it does to the machine?—The holder of a debenture who has accepted 5 per cent. for 30 years on the capital he has loaned to a company will of course be very unfortunately placed if the general level of prices doubles during the course of that time.

4644. As it has done.—Yes. On the other hand, with respect, I should like to pick up one of your points, where you said that physically these assets are unchanged. Physically the process of production wears them out, and at the end of 15, 20 or 25 years, whatever time it may be, the problem is to replace them, and they can only be replaced if resources have been accumulated for that purpose. If not, they have to be replaced out of new savings that ought to be used for industrial expansion.

4645. Yes. I think I could perhaps put more clearly what is in my mind if I were to give you an illustration: three men twenty years ago had £20,000 to invest; one man invests in debentures, another man invests his £20,000 in property which comes within the Rent Restriction Act, so that he cannot have any increase, the other man invests his £20,000 in a business, and we will say £15,000 of that is expended in machinery. With the changing value of money all three are placed at a disadvantage, but you say as regards the man with his debentures, yes, it is the luck, he is now returned less than half what he expected, the man with his property likewise, but when it comes to the man with the business, so far as that £15,000 worth of machinery is concerned he must not be placed at a disadvantage. This to you economists may appear very, very simple, but it is the human side of the matter at which I am looking. I can see the position with regard to the machinery, the difficulty with regard to replacement value, if you like, the case that there is for it, but when I make a comparison then the owner of the machine appears to be placed in a much more favourable position than the owner of debentures or any fixed interest bearing stock, or the owner of property.—Yes, I appreciate that point, *Sir Harry*. The objection to the argument *Mr. Crowther* and I put forward about replacement costs is often put in such terms as these: "Why should you introduce this special benefit for the owner of share capital?" As we see it, it is not an argument directed at *Americus*, but is really an argument which is concerned with maintaining the physical stuff of industry, and the argument is strengthened by the conviction that by

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and large the only means by which industry can maintain itself and improve itself is through the surplus of profits which arises and is ploughed back into its own capital from year to year.

4646. Assuming, from the purely business standpoint, that effect must be given to your theory, have you given any consideration to what I will call the human side of the question, whether there are any suggestions or means which the economists can tell us to do something equally helpful on the human side?—Mr. Crowther: I believe I can give a direct answer to the three cases you had in mind. The theory of the thing, as I see it, is that when a man invests in capital of any kind there is no reason why the State should guarantee him against misadventure, or indeed should prevent him from being lucky, but before he is taxed on the income from that capital he should be allowed to make, tax free, such expenditures as are necessary to maintain the capital. Now take your three cases. At the end of the twenty years your first man who has invested in the debenture has his capital, he has the debt of £20,000 owed to him; that is what he bought, and that is what he has got in the end. Your man with the house has not indeed been allowed to put up the rents, but he has been allowed tax free the expenditures necessary to maintain these houses, so that at the end of the 20 years he can say: "There are the houses I bought", and there they still are. What we are arguing is that the man who put his £20,000 in machinery should be exactly in the same position and be able to say at the end of 20 years: "I invested in a loom, and there it is".

4647. Yes, I do not think I can argue the case you put, but I bring it right back to the human element; the return for the first man, where he got one loaf of bread, he is today getting less than half a loaf; where the man with his property was getting one loaf of bread, he is now getting less than half his loaf; but you say because the other one was lucky enough to put it into a business which had machinery, he has still got to have his loaf.—No, I should say the first man is unfortunate because he made a misjudgment in the investment of his capital. After all, if prices had gone the other way he would have been the most fortunate. He exercised his judgment freely. As for the human element, I suggest that there is a very close analogy with the price that is paid by industry to the labour which is used up in the course of producing something. Nobody ever suggests that the payments made to labour that are allowed before profit is struck should be limited to the value which was put upon that labour when it came into existence, when the labour was born. No, the allowance which is made for the use of the labour is adjusted from time to time according to the value of the money, and whatever adjustment is so made it is allowed to be deducted before profits are struck. All we are arguing is that the same should be done for machinery as for labour.

4648. Professor Hicks: Mr. Crowther, I would like to begin by asking quite a small question. In your first memorandum, at the end of paragraph 2 (i), you are talking about the disincentive effect of profits tax, and you made a remark which I would just like to have explained to me; you say: "Profits tax . . . has an undoubted disincentive effect upon industrial, and particularly commercial, enterprise. Why particularly commercial?—It is so long since this document was drafted, I cannot . . .".—Mr. Bird: I should imagine that point was really this, that the impact of profits tax on commercial enterprise is frequently an impact on the smaller type of company where the margin of disincentive is felt particularly keenly.

4649. I do not want to press that point. Might I go back now to replacement cost? I would like to put to you that one way in which the arguments which you have been putting forward, very interesting arguments, could be taken, would be to say that the obvious deduction to be drawn from them was not, in the first place at any rate, a reform in the system of taxation, but a reform in company law. The first necessity is that the businesses should do their accounts on a basis of replacement cost, and that could easily be effectively enforced quite independently of anything which is done on the taxation side by making it illegal for them to pay dividends out of capital, in the sense of real capital. And I would like to suggest further that if that were done, drastic

and unpleasant measure as it might seem, the economic effects would be much more obviously in the direction of what one wants to encourage than the particular proposal which you put forward, because it seems to me, that if one considers a period when demand is excessive and prices are rising in consequence, and nominal profits are rising in consequence, that that is a time when the natural criterion of policy generally accepted by economists and by the Government nowadays would be in the direction of trying to minimise expenditure. Now a reform in the system of accounting would tend to reduce expenditure, but the same object is not helped by a reduction in tax, which is what would be the natural result of a proposal such as you are making.—Mr. Crowther: I think if the larger proposal is taken as embracing the smaller, I would have a lot of sympathy for it, at least in principle, but if it were suggested that the changes Professor Hicks has indicated should be made in company law and practice without a reform of the taxation system, then you would get the peculiar position that companies had to say to their shareholders that they had no profits and could not declare a dividend, but that they would pay tax as if they had, which would be curious to say the least.

4650. It would be curious, but would it not at the same time be the right thing to happen?—It would certainly be unjust, though it might have certain economic advantages.

4651. Might I ask you to consider a particular case, which happens to be, I think, a rather realistic case, being not so very far away from what we have been experiencing in the last couple of years. Supposing that the economy is disturbed (by putting it in this way, what I want to do is to rule out of our minds all other sources of disturbance) supposing the economy is disturbed solely by the fact that the Americans suddenly decide that they want to buy a very largely increased amount of the sorts of goods which we normally import, particularly in the form of raw materials; supposing that that is the sole cause of disturbance with which we are concerned, that produces conditions in which it is probably impossible for this country, without running an extreme deficit on its balance of payments, to maintain the stocks, the real stocks, the physical stocks kept by industry, intact. No tax policy, and in fact no policy probably, can enable the industry of this country to maintain its stocks of raw materials intact in such conditions. At any rate, it can only be done by running an extreme deficit on the balance of payments. In circumstances such as that, is it desirable that more money should be put into the hands of industry to hold either as idle balances or to be spent in a way which would push up the prices of stocks further?—I can follow the economic reasoning, but I think it would lead one into very curious results. One can imagine circumstances in which it might be much the quickest way of producing a necessary sharp deflation, to legislate that every third person passing along the Strand on a given morning should be fined £100, but it would not necessarily commend itself on other grounds, and I think what Professor Hicks is suggesting would have a similarly arbitrary element in it.—Mr. Bird: May we not also look at Year 2 of this proposition, when the Americans stopped buying. In Year 2, the profits of British industry, having been inflated as a consequence of the prices rising as a result of American buying, will fall to be taxed, and at the same time the problem of replacing those stocks arises. At that time, although presumably the prices of those raw materials would have fallen, the resources available after taxation of the inflated prices of Year 1 may well be less than adequate to replace them.

4652. Thank you, that is a very interesting answer. There is just one other thing I want to ask, and that is concerned with your proposal about the personal income tax. I am not quite sure whether anything was said in the part of the discussion I missed, about that, and I may be repeating what has already been covered, I hope not. I am not really quite clear what is the precise form of your proposal, at the lower end, even after the discussion which I heard. You propose, do you, that all income whatever should pay at a flat rate, but that vouchers should be handed out in accordance with some system of allowances, which could be used in payment of tax? Suppose that the amount of the vouchers which a particular person receives during the tax period is greater than the tax which he is due to pay, what happens?—Mr. Crowther: I should say he does not get the balance in cash.

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4653. He does not get the balance in cash?—No.

4654. In that case, what really is the advantage of the voucher system? Could not the whole thing be done by offsetting?—Yes, but the voucher is the employer's authorisation to do the offsetting.

4655. But surely in fact he does it at present under P.A.Y.E.?—He does, under a most complicated and difficult system. The advantage of the system suggested is that he should reckon his tax and pay it over to the Revenue as a flat 10, 15, 20 or 25 per cent. or whatever it might be, of his wages total, then in making up each man's pay packet he should look and see what vouchers he has.

4656. *Professor Hicks*: But that really does no more than clear up one of the complications of the present system, due to the varying rates of income tax at the lower end. If in fact it were possible to recommend that the lowest reduced rate of income tax were to operate throughout the wage-earning group, and if all taxation above that were collected on some different system, which I take it is more or less what you are proposing as far as that is concerned, supposing that were done I quite fail to see the advantage of your system over P.A.Y.E.

4657. *Chairman*: Mr. Crowther, I understand you have an engagement which you have told us you would like to keep?—I have indeed, Mr. Chairman, I have been getting a little anxious.

4658. *Chairman*: I think I ought to add, Professor Hicks, that I think Mr. Crowther's line was that he did not think that, so far as the administrative details were concerned, he knew enough about the background, which the United Revenue knew, to be able to deal with questions of that kind in any great detail, so I think perhaps you will not get a great deal out of him and we ought to release him.

Mr. Crowther withdrew.

4659. *Chairman*: I would like just a word with Mr. Bird, about one or two material things which have cropped up. There was the question of your extremely interesting proposals about a separate tax on company profits cut loose from the standard rate, and Mr. Crick did suggest that it is not very easy just by question and answer to me what it is that you have got in mind as a system. If you could cast your proposals in the form of two or three examples, it would help us very much to see what it is you are proposing. Could you do that for us?—Mr. Bird: Certainly.

Chairman: Thank you very much, we are greatly obliged to you.

Mr. Bird withdrew.

MR. S. P. CHAMBERS, C.B., C.LE., MR. C. D. HELLGAR AND MR. A. G. DAVIES, on behalf of the Federation of British Industries, called and examined.

MEMORANDUM SUBMITTED BY THE FEDERATION OF BRITISH INDUSTRIES

The Effects of Inflation on Industrial Capital Resources A Case Study

FOREWORD

Since 1939 costs and prices in the United Kingdom have been rising virtually without pause. Throughout this period taxation has been maintained at a level of over 40 per cent. of the national income. In no other industrial country has a similar rate been even approached. This combination of inflation and high taxation, coupled with the deficiencies of the existing method of computing depreciation allowances, has seriously impaired the capacity of industrial undertakings to maintain their capital resources and to finance essential expansion.

Various aspects of the physical and financial problems affecting capital investment in industry have from time to time been dealt with in a number of independent enquiries. For example Professor E. A. G. Robinson, elaborating an earlier series of estimates by Professor Parish, estimated in an article in the May, 1950 issue of the *Bulletin of the London and Cambridge Economic Service* that at the rate of investment then in progress the pre-war level of fixed capital per head in industry and the public utilities would not be restored until 1954.

More recently, in July 1951, the *British Bankers' Association* published the results of an analysis of the current assets and liabilities in 1946 and 1948-50 respectively of some 1,500 small and medium-sized manufacturing and commercial companies. This revealed a continuing deterioration in the aggregate liquid resources of these companies in the face of rapidly rising prices and heavy taxation. The authors concluded that in the post-war period, the increase in the capital resources of the business undertakings covered by their report had failed to keep pace with the rise in their financial requirements.

As yet no attempt has been made to present the case solely from the point of view of manufacturing industry. The attached case study is an attempt to repair this deficiency. In it a Panel set up by the Federation of British

Industries has analysed the balance sheets of some eighty firms over the period 1938 to 1949, with a view to ascertaining how far the capital resources of manufacturing industry have been affected and as a means of bringing out some of the implications for industry should present trends continue.

The case study is based on figures derived directly from published records, supplemented by the best available estimates where factual evidence could not be obtained. Complete statistical accuracy cannot be claimed for these estimates nor for the capital prices index employed in the revaluation of fixed assets. Nevertheless, the conditions which emerge, even if stated in broad terms, are in line with those of the analyses referred to above and also conform with those contained in the reports of the chairman of a wide range of public companies over the past three years. They show that although profits have risen generally, too little has been left after taxation to permit industry to withstand the cumulative pressure of inflation on its capital resources. They further stress the need for the individual company itself in present circumstances to take all practicable defensive measures against the progressive attrition of its capital resources, by setting aside the maximum practicable reserves to offset the effects of inflation on stocks and fixed assets. By so doing, not only will it assist in bridging the gap between permitted depreciated allowances and replacement costs, but will also help to strengthen the case of industry generally for a reshaping of the country's national taxation policy in a direction calculated to alleviate the burden at present hampering the effective operation and development of British industry at large.

I. The Problem in General Terms

1. It is frequently contended amongst industrialists that the capital resources of industry are not merely being strained but are in danger of exhaustion as the result of combined inflation and high taxation. Yet at the same time complaints are repeatedly heard from other quarters at what are described as the excessive profits being made by industry.

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MR. S. F. CHAMBERS, C.B., C.I.E., MR. C. D. HELLAR AND MR. A. G. DAVIES

[Continued]

2. The twin questions of the erosion of capital and the inadequacy of profits are clearly inter-related, for unless industry is able to provide from its own resources for the maintenance intact of its productive capacity, it is, in effect living on capital. The maintenance of capital intact, in the sense of preserving the productive capacity of the enterprise, is, in fact one of the most important responsibilities of management. For the fulfilment of this responsibility only the balance remaining after provision has been made for the maintenance of capital can be regarded as "profit" and as available either to meet taxation or for distribution as dividends.

3. If the value of money remained constant, an increase or decrease in the capital resources of industry would be fairly easy to measure. But when the value of money is changing as progressively as it has done in recent years, then there is great difficulty in interpreting the published accounts of public companies so as to measure changes in capital. This difficulty arises from the use, in a long period of rising prices, of accounting methods which assume a stable value of money. Since 1938 the money cost of maintaining intact a given volume of real capital including fixed assets, stocks and book debts has greatly increased. Despite this, balance sheets by tradition treat all as being of equal value, whether they are as of 1951, 1938 or 1900. The convention is that in calculating profit it is sufficient to put aside a sum equal to the cost of the asset whenever it was bought, despite the fact that the replacement will actually cost much more. The connection between the maintenance of capital and the level of profits is clear; in so far as the published accounts of companies understate the requisite provision for maintenance of assets, they correspondingly overstate the real profits earned.

4. The assumption of stable prices is embodied in the Inland Revenue system of taxing profits. The tax-free depreciation allowances are normally sufficient to provide for the renewal or replacement of fixed assets at their original cost. If, however, the new assets cost more than the old, depreciation funds set aside on this basis will purchase fewer new assets. Unless other funds are available, either out of retained profits or from outside sources, capital will be depleted and production must eventually decline.

5. A simple example may serve to explain this more clearly. Suppose three machines were bought in 1938 at a total cost of £15,000 with an estimated life of fifteen years. The annual deduction from profits for depreciation on the basis of original cost will be £1,000. By 1953, £15,000 will be available for replacement, and for tax purposes, the capital will have been maintained intact. But if, by 1953, the cost of the machines has trebled, the accumulated fund will be sufficient to replace only one of the three machines unless a further £30,000 can be found out of retained profits or elsewhere. Retained profits used for this purpose will be subject to tax even though they are required merely for maintaining existing capital. So a tax apparently levied on income becomes effectively a tax on capital. If net profits are not sufficient, the capital will not be adequate to keep production at the same level as before.

6. The problem of replacement of circulating assets arises in the same way. Suppose for example that at the beginning of a period of rising prices, a firm has on hand 100 tons of material which cost £100 per ton, the total value of the stock being £10,000. Suppose also that in the course of a normal year's trading the firm uses up and replaces each month 100 tons of raw material and that over the period prices rise from £100 to £150 per ton. Then, at the end of the period, the firm will still have in stock 100 tons of material, but bought at £150 a ton, and now valued in the accounts at £15,000. Although this stock is the same in physical terms at the beginning and the end of the period a profit of £5,000 will be recorded on account of the rise in value. This book profit will be taxed.

7. This is a necessarily oversimplified illustration dealing with a single raw material but in periods of general inflation it applies equally to all stocks. When prices generally are rising it thus happens that "profits" as shown in firms' accounts which if paid away in tax or in dividends will not then be available to maintain the physical volume

of stock for the same trading as before. Consequently the stock must be reduced or the money found from some other source. If a Stock Reserve is created from other retained profits to cover the cost of replacing stock at increased prices, no tax allowance is given and the reserve has therefore to be made out of what is left after paying tax on the full profit. Here again if the total net profit is not high enough to cover replacement costs, the alleged tax on income is in effect a tax on capital.

8. Prices have risen generally over the past thirteen years. Gross profits have also risen but to a considerable degree this has been an automatic consequence of the inflation of stock values, as explained above. But throughout this period taxation has been levied at exceedingly high levels on the whole of the profits shown. It is clear that unless industry is able to set aside out of the profits remaining after taxation sufficient funds to meet the replacement cost of its assets it is living on capital. It is therefore vital for industry that the facts should be established. So far however, very few attempts have been made to examine the problem in quantitative terms. The amount of relevant information available in published economic statistics is small and no answer can be obtained from this source. The F.B.I. has attempted to obtain from its member companies, by means of a questionnaire, the data necessary to reach a conclusion. The results of this investigation are analysed below.

II. The Experience of Industry:

Evidence from the F.B.I. Questionnaire

9. Eighty companies replied to the questionnaire; they included large, medium and small firms from all sections of industry. It is not claimed that they are completely representative of industry as a whole and the results are presented simply as a "case study" of a number of companies. Together they employed in 1949 over 600,000 employees and possessed total assets (at book value) of over £1,000 millions. As such, we believe that the conclusions drawn from this evidence are of considerable importance.

10. The figures collected have been examined in order to discover what light they throw on three main problems:

- How did the 1949 capital assets of the companies concerned compare, in real terms, with those of 1938?
- How had the companies financed the increased money-value of capital needed to run the business in 1949 compared with 1938?
- In the light of the answers to (a) and (b); and of such other relevant factors as the volume of production in 1938 and 1949 respectively, what conclusions may be drawn as to the adequacy of capital resources in 1949 and in the future, and of the level of profits at present earned in industry?

(a) Comparison of the real value of assets in 1938 and 1949

11. Between 1938 and 1949 the total net assets of the eighty firms (at book value) rose from £447 millions to £809 millions. (See Appendix A Table I). The changes which occurred in the real value of these assets can however only be measured after adjustments for the change in the value of money. For practical purposes these adjustments may be confined to those assets for which provision for maintenance and replacement is necessary, that is, in the fixed assets group, buildings, plant and machinery, and in the current assets group, stocks, debtors and cash assets (less trade liabilities). The remainder (land, goodwill, patents, trade investments etc.) may conveniently be excluded from the reckoning as there is normally no question of replacing this type of asset.

12. The total fixed and current assets shown by the balance sheets are:—

Assets	1938	1949	Increase over 1938
Buildings, plant and machinery ...	£ million 127	£ million 197	£ million 70
Net current assets ...	157	414	257
TOTAL ...	284	611	327

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13. It is not practicable to make a strictly accurate revaluation of the 1938 assets. It is however generally accepted that in 1949 average prices of plant, machinery and buildings were not less than $2\frac{1}{2}$ times those ruling in 1938. This figure is in line with the official price index for plant and machinery exported and with the index used by the E.C.A. Mission to Europe in "Facts about British Economy" (1950).

14. 1938 Assets revalued at 1949 prices: The written down book value in 1938 of the plant, machinery and buildings of the eighty firms was £127 millions. It is impossible to discover how far this figure represents the actual value of the assets in terms of 1938 prices but it seems reasonable to assume that the true figure is unlikely to be less. The E.C.A. Index of 249 (1938 = 100) applied to this 1938 book figure gives a value for Plant, Machinery and Buildings of about £315 millions at 1949 prices.

15. 1949 Composite book value adjusted to 1949 prices: (See Appendix B). To obtain a comparable figure for the plant, buildings and machinery actually held by the same companies in 1949, account must be taken of the fact that the book value of the assets shown for that year (£197 millions) covered assets bought at various prior dates and therefore at various values of the £. To bring all these to the equivalent of 1949 £s, those bought some years ago have to be re-valued upwards substantially and those bought recently re-valued by smaller amounts.

16. For this purpose the annual indices of capital goods prices quoted in the E.C.A. publication referred to above have been employed. The actual figures of net annual expenditure on fixed assets and of the depreciation made by the eighty companies have been adjusted in each case to their 1949 equivalents.

17. The results of this calculation suggest that in terms of 1949 prices the fixed assets shown in the 1949 balance sheets were worth £304 millions. A comparison of this figure with the revalued 1938 total of £315 millions (para. 14) indicates a slight reduction in real terms.

18. Other data supplied by the eighty firms does however permit an alternative approach which suggests that the real value of fixed assets may have increased somewhat.

19. The eighty firms estimated that at 1949 prices the replacement cost of their fixed assets was £783 millions: they also gave the cumulative depreciation provision required on a replacement cost basis as £427 millions. The difference between these two figures gives a written down book value of £356 millions at 1949 prices. This is 13 per cent. higher than the revalued 1938 total of £315 millions given in paragraph 14.

20. Between 1938 and 1949 the book value of fixed assets rose from £127 millions to £197 millions (Appendix A, Table I). On the hypothesis that the figure of £197 millions represents a 13 per cent. expansion in real terms over the 1938 figure, then it appears that £174 millions ($\frac{1}{13} \times 197$ millions) was the equivalent in 1949 of the 1938 volume of assets. On this basis it can be said that of the £70 millions increase in book values £23 millions represented expansion while the remaining £47 millions was required merely to maintain existing capital intact. On the method of calculation used in para. 17 the whole of the £70 millions rise was required for the latter purpose.

21. In the current assets group, it is possible to adjust for price changes between 1938 and 1949 by using the "Industrial Materials and Manufactures" component of the official Index of Wholesale Prices. In 1949 this stood at 241 (1938 = 100). On this basis the 1938 net current assets valued at £157 millions in 1938, were worth £378 millions at 1949 prices. The current assets shown in the 1949 balance sheet at £414 millions are valued substantially at 1949 prices. Thus of the £257 millions increase in the money value of current assets, only some £36 millions represents an actual physical expansion. The remaining £221 millions merely represents the increased cost of financing the same volume of current assets.

22. In view of the different results given by the two methods of revaluing the 1949 fixed assets, the answer to the first main problem (a) in para. 10 cannot be given

with complete precision. Nevertheless the broad picture is clear.

In terms of 1949 prices current assets in 1938 were worth £378 millions and fixed assets £315 millions (see paragraphs 21 and 14), giving a total of £693 millions.

23. In 1949 on the other hand current assets were worth £414 millions at 1949 prices and fixed assets £304 millions on the lower valuation and £356 millions on the higher. These estimates give totals of £718 millions and £770 millions respectively according to the method of calculation adopted, showing increases of £25 millions or $3\frac{1}{2}$ per cent. on one method and £77 millions or 11 per cent. on the other.

24. Yet owing to inflation it has been shown that merely to maintain current assets intact required extra finance to the extent of £221 millions (paragraph 21), while according to the method of valuation adopted somewhere between £47 millions and £70 millions was required for the same purpose for fixed capital (paragraph 20) making a total extra finance required of £268—£291 millions.*

(b) Financing of assets

25. How was the extra money needed actually found? Between 1938 and 1949 according to the balance sheets (Appendix A Table I) the total assets of the eighty companies increased by £362 millions, which was financed by:—

	£ million
Share issues (including share premiums)	52
Borrowing (short and long term)	60
Increase in tax reserve (for subsequent years liability and deferred liabilities)	35
Decrease in minority interests	-4
	<hr/>
"Profits" retained in the business	163
	<hr/>
	362

26. The increase in undistributed profits falls far short of the £268—£291 millions necessary even to maintain existing capital intact. No business looks elsewhere for finance—for which it must pay a price in dividends or interest—if it has sufficient left of its own profits after taxation to maintain its capital. The extent to which these eighty firms have been forced to seek funds from outside demonstrates clearly the inadequacy of profits after taxation. Any suggestion that the companies could have avoided seeking outside finance by reducing the amount of profits distributed and so retaining more in their businesses is not borne out by the facts elicited by the questionnaire: between 1945 and 1949 the proportion of total profits distributed fell from 27 per cent., to 22½ per cent. while the proportion undistributed doubled, rising from 14½ per cent. in 1945 to 28 per cent. in 1949.

27. The answer to the second problem referred to in paragraph 10 therefore is that the additional money required barely to maintain capital has been found mainly from profits but these being inadequate considerable new capital had to be raised or borrowed.

(c) Adequacy of capital resources

28. Were the capital resources of the eighty companies "adequate" in 1949 judged by comparison with 1938? The answer depends largely on the relative volumes of production in the two years. The total number employed rose by about a third (Appendix A Table IV) and this fact taken together with the general trend of industrial production would indicate a rise in the volume of production since 1938 of at least a third. In 1938 fixed assets per employee in the eighty companies averaged £28 valued at 1949 prices whereas in 1949 the figure was £44. These facts demonstrate that a substantial increase in output was combined with a substantial fall in the capital investment per unit of output and per employee. Part of

* It is probable that the figure of over £291 million, derived from the E.C.A. index numbers, is more accurate than the estimate of £268 million which is obtained from the firms' answers to the questionnaire. In the latter case 80 different companies' calculated or estimated figures have simply been totalled and it was not possible to ensure that a uniform method of calculation was adopted.

† Data before 1945 not available: this was the E.P.T. period.

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the explanation may be found in the more intensive use of equipment but this possibility is limited.

29. The depletion of industrial capital by inflation combined with high taxation is a slow and for some time an imperceptible process. This is because it happens gradually and the running down of financial capital can be temporarily prevented from depleting physical capital by outside finance and by postponement of replacement. The problem of maintaining capital intact is likely to grow more acute. The eighty companies estimated that the depreciation which should have been provided on the basis of replacement cost of fixed assets in 1949 was £427 millions. The provision actually made was £189 millions—a shortfall of £238 millions.

30. It may be argued that companies' resources are sufficient to cover this shortfall. The reserves of the eighty companies increased by £199 millions between 1938 and 1949 but this amount was not even enough to finance the extra £212 millions needed for the increase in stocks alone. (See Appendix A, Table 1.)

31. The replacement of fixed assets is a gradual and long-term matter and in all replacement there is some element of expansion to be derived from the continual improvements in machine efficiency. Nevertheless there does exist already a serious deficiency between replacement costs and accrued depreciation funds which must ultimately be met if productive capacity is not to decline.

32. Not only were there insufficient reserves in 1949 to provide for the replacement of fixed assets but if the eighty companies continue to provide depreciation on book values and not on current prices there will be a further deficiency of depreciation to the extent of at least £107 millions—the difference between the 1949 value of fixed assets £304 millions and the book value £197 millions. If the higher figure of £356 millions is taken for the 1949 value, the deficiency of depreciation will be correspondingly higher. By the time the assets existing in 1949 are renewed the eighty companies will have to have found about £350 millions of new money in addition to their resources of capital, reserves and borrowings in 1949. This £350 million has not all to be found this year or next year but probably the bulk of it will have to be found within the next fifteen or twenty years. If twenty years are allowed, the eighty companies will have to put aside at least £174 millions a year for capital replacement in addition to their normal depreciation charges: in other words, nearly as much again as the amount actually provided in 1949.

33. The evidence of the depletion of circulating capital is equally strong. In 1938 net current assets amounted to 32 per cent. of the turnover of the eighty companies; in 1949 this proportion had fallen to 24 per cent. Whatever the reasons for this decline, it does indicate that, judged by the standards of inventory levels, etc., which the companies concerned considered reasonable in 1938, their 1949 position overall showed a definite deterioration. Such further increase in raw material prices makes it more difficult to maintain liquidity and the decline in liquidity is illustrated by the decrease in cash assets. Cash in 1949 was at least 30 per cent. lower than in 1938 after adjusting for the rise in prices between the years.

III. Conclusion

34. At the present time it is vital that British industry should not merely maintain production but should increase it as rapidly as possible. The main conclusions to be drawn from the figures obtained from the survey are disturbing. The amount of undistributed profits put to reserve in the last few years has been inadequate to maintain industry's capital over the years. Yet the proportion of profits distributed has not risen but fallen. It is clear therefore that the levels of prices and profits have not been excessive, but too low to sustain the burden of taxation under existing methods of competition and to maintain the productive capacity of industry. Both employment and the standard of living ultimately depend on that productive capacity.

November, 1951.

APPENDIX A

TABLE I

COMPARATIVE SUMMARY OF BALANCE SHEETS OF
80 COMPANIES INCLUDING U.K. SUBSIDIARIES

	1938	1945	1949
	£ million	£ million	£ million
FIXED ASSETS (at written down book value)			
Land (where separate figures available)	7	7	8
Buildings, plant and machinery	127	112	197
Total fixed assets ...	134	119	205
CURRENT ASSETS			
Stocks	119	183	331
Debtors	57	142	206
Cash and cash assets	34	140	95
Total current assets ...	210	465	632
less current liabilities ...	73	166	238
Total net current assets ...	137	300	404
OTHER ASSETS			
Goodwill, patents, etc.	55	57	57
Investments, including investments in subsidiary companies not consolidated	101	90	133
Total other assets ...	156	147	190
TOTAL NET ASSETS ...	447	566	809
Financed by:			
Share capital	273	283	311
Minority interests	23	19	19
Share premiums	10	12	24
E.P.T. post-war refunds	—	—	14
Reserves created by revaluation of assets	4	6	11
Other reserves including P/L Balances	94	151	272
Borrowed money—long term	25	25	40
Borrowed money—short term	6	21	51
Deferred liabilities	4	11	13
Tax reserves	8	34	54
TOTAL NET ASSETS ...	447	566	809

TABLE II

	£ million
A.1. Total original cost of fixed assets shown in 1949 Balance Sheet (excluding land where possible)	375.3
2. Estimated gross cost, irrespective of the degree to which the above assets had depreciated of replacing them at new at current prices	782.9
B.1. Total Depreciation Provision to date in Accounts on the Assets in A.1 above ...	188.8
2. Estimated Total Depreciation Provision to date required according to existing methods to provide for depreciation on the assets as valued in A.2 above	426.5
C.1. Depreciation Provision made in 1949 ...	79.4
2. Average Annual Depreciation required to achieve the replacement value of the Assets as valued in A.2 above without deterioration in the efficiency of the plant	40.1

N.B. In some cases the above figures are not strictly comparable with those given in the summary of Balance Sheets. As a result the Balance Sheet figure for the written down value of buildings, plant and machinery differs from that obtained by subtracting total depreciation from original cost by about 5 per cent.

TABLE III
SALES TURNOVER
EXCLUDING INTER-COMPANY TURNOVER

			£ million
1938	...	...	484.5
1945	...	...	1,097.5
1949	...	...	1,656.3

TABLE IV
AVERAGE NUMBERS ON TOTAL PAYROLL INCLUDING WAGES
EARNERS, SALARIED STAFFS AND DIRECTORS

			£ million
1938	...	...	502,240
1945	...	...	637,026
1949	...	...	677,619

APPENDIX B

CALCULATION OF CURRENT VALUES OF FIXED ASSETS IN 1949

Year	ACTUAL			ADJUSTED			Price Index
	Written down value at beginning of financial year	Net annual expenditure on fixed assets	Depreciation	Written down value at beginning of year adjusted to 1949 price level	Net annual expenditure on fixed assets adjusted to 1949 price level	Depreciation $\frac{c(a+b)}{(a+b)}$	
	(a)	(b)	(c)	(d)	(e)	(f)	(g)
All figures are in £ million							
1939	126.6	15.0	10.5	215.2	35.9	26.0	104
1940	131.1	8.3	11.4	225.1	16.0	27.9	123
1941	128.0	4.7	9.9	213.2	7.8	23.9	150
1942	122.8	5.6	9.8	207.1	8.6	23.3	163
1943	118.6	5.6	10.3	212.4	8.2	24.1	170
1944	113.9	6.4	9.6	206.5	9.2	22.0	173
1945	110.7	10.8	9.7	211.7	15.3	21.5	176
1946	113.8	25.5	12.2	247.5	33.6	25.0	189
1947	125.1	31.0	13.4	256.1	33.4	25.0	218
1948	142.7	41.3	10.2	266.5	42.8	17.1	240
1949	173.8	41.8	19.0	252.2	41.8	29.4	249
1950 (1)	196.6			304.4			

Notes:
(1) Equivalent to end-1949 values.
(2) The adjusted depreciation bears the same proportion to the adjusted written down values at the beginning of the financial year plus additions (adjusted) as actual depreciation bears to actual written down values plus actual additions.

EXTRACT FROM A FURTHER MEMORANDUM SUBMITTED BY THE FEDERATION OF BRITISH INDUSTRIES

Comment on the Report of the Millard Tucker Committee on the Computation of Trading Profits for Taxation Purposes

1. In the Budget speech of 1951 the then Chancellor of the Exchequer, referring to the Millard Tucker Report, stated that before taking action on the Report it would be necessary to await the reaction of industry. (H. of C. Hansard 10th April 1951, Col. 854).

2. The Federation has closely studied the Report and in particular the recommendations it contains. It now records its views in the hope that they will be of assistance to the Chancellor and his advisers in contemplating action on the Report, and to the Royal Commission on the Taxation of Profits and Income, in so far as any of the issues are to be further considered by that body or have implications on the subjects of its study.

3. Many of the recommendations in the Report which concern industry, the Federation accepts as sound or does not desire to press further. Where no mention is made of any particular matter, it can be taken that either the Federation agrees or that the matter is not within its sphere of interest.

Inflation

20. The Federation does not agree with the suggestion in the Tucker report that the best way of modifying the distortions in the measurement of profits caused by inflation is to rely upon a system of initial allowances for new capital expenditure. Whatever the merits of the system of initial allowances for the purpose of providing immediate resources to assist in the financing of new capital expenditure, and thus of encouraging the modernisation of the country's industrial equipment, this is not, in the Federation's judgment, the way to deal with the entirely separate problem of removing the inflationary element from the figures of profits computed upon conventional lines which assume that the value of money remains unchanged. The limited advantages of the initial allowances

are recognised where replacements are made regularly at short intervals, but this redistribution of depreciation allowances between different years, without increasing the sum total of the allowances, is no solution of the main problem. In any event the precipitate manner in which these allowances were withdrawn without dealing with the main problem is deplored.

21. The Federation also records its view that the suggestion made by the Committee that the amount of initial allowances and hence the liability to tax should depend upon the judgment of His Majesty's Treasury of the importance of the industry to the national economy, offends an elementary principle of taxation: in general the tax charge should depend upon the amount of income or profits and not upon an estimate of the importance of the activities giving rise to the income or profits. A departure from this principle could lead to arbitrary administration.

22. The main question of the effect of inflation upon the computation of profits should in the Federation's view be re-examined. There are two different but related subjects.

One is to ensure that for any given year the profit is assessed for tax should represent as near as possible the true surplus of the year, after making such deductions as are necessary to ensure that productive capacity is maintained. For this purpose the deductions in respect of fixed assets should be such that they represent a due proportion for the year of the value at current prices of the assets utilised. A similar principle applies to the deduction to be made for stocks used up during the year.

The other problem is to determine what should be done about the deficiency of the deductions in the past twelve years during which there has been a substantial rise in price levels, so that the allowances given on the basis of the original cost of the plant or stocks are inadequate, taking one year with another, to provide the full amount needed for the replacement of the plant or stocks at current prices.

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It is desirable to treat quite separately these two problems.

Paragraphs 23 to 32 are concerned with the first problem and paragraph 33 with the second.

23. The difficulty of making adequate provision for the depreciation of fixed assets during a period of rising prices is now familiar. Under the present practice the sum of the depreciation allowances over the life of a building or a piece of plant or machinery will, with any balancing allowance or charge, equal the original cost of the plant. This original cost incurred some years ago will be far below the cost of replacement at current prices. Depreciation provisions based upon the original cost will therefore not provide a fund which will equal the replacement cost. For this reason under present practice the capital invested in this plant or machinery will be maintained in money terms and not in physical terms. £10,000 invested in a particular type of plant today will in physical terms be much less than £10,000 invested in the same kind of plant ten years ago. This is the problem which faces industry, which, of course, has to maintain its equipment in physical terms if its productivity is not to fall.

24. If we have to contemplate the present level of inflation as a permanent phenomenon, it will be necessary to consider the incorporation in commercial practice and in our income tax rules of some method of adjusting allowances year by year to take into account the fall in the value of money, so that the profits as shown in accounts, and as computed for tax purposes, do not exceed the true economic profit after maintaining physical capital. Whatever may have to be done on a more permanent basis, some immediate action is necessary because allowances in the past few years have been inadequate and this has resulted in the running down of capital. While the present conditions of inflation last, some temporary adjustment to our taxation rules is essential if the physical capital of industry is not to be seriously depleted. Many industrial concerns have made additional provisions in their accounts in order to provide funds for the replacement of plant at current costs but these provisions are not allowed as deductions in the tax assessments. The Federation suggests that the simplest method of dealing with this problem, so far as fixed assets are concerned, is for additional allowances to be given for tax purposes, these additional allowances being kept quite distinct from the wear and tear allowances made on the normal lines under existing law and practice.

25. These additional allowances should be deducted from the profits for the year and kept outside the normal wear and tear computations which would be based upon the original cost of the assets as at present. The extent to which a wear and tear allowance in any year is deficient will depend upon the year in which the assets were purchased or constructed. For example, the wear and tear allowances for the income tax year 1952-53 in respect of plant bought in 1951 will be adequate if there is no substantial increase in costs of construction between 1951 and 1952. The normal allowances for 1952-53 in respect of plant bought before the war will be based upon constructional costs amounting to about one-third of constructional costs today; for such plant an additional allowance of twice the normal allowance should be given. Between these extremes, the deficiency in the allowances will vary as costs have risen year by year since the beginning of the war. It is possible from the existing wear and tear computations, to divide the figure upon which the normal wear and tear allowances will be given for 1951-52 (or whatever year is taken as the starting year for the additional allowances) between the amount appropriate to assets acquired prior to 1939-40 and amounts appropriate to assets acquired in each subsequent year. (It would perhaps be impracticable to analyse the figures prior to the year 1939-40.) It would not be difficult to calculate additional allowances by multiplying that proportion of the normal allowance for the current year which relates to plant installed in each of the earlier periods, by a factor which reflects the increase in construction costs between the period in which the plant was acquired and the current year for which the allowance is being given.

If additional allowances are given on the basis proposed, it will be necessary to consider the calculation of any balancing allowance or charge when the assets in question are sold or scrapped. It will be necessary to take into account the sum of all the allowances given in the

wear and tear computation plus this additional allowance, but for this purpose reference will be made not to the original cost of the asset in question but to the original cost written up on the index principle, using the index appropriate to the year in which it was bought. In calculating the balancing charge or allowance, it will be necessary to assume that notional allowances were given for years prior to the introduction of these additional allowances, unless at this stage relief is also to be given in respect of under-allowances of past years. This question of past under-allowances is taken up again in paragraph 33.

26. It is recognised that the increase in the constructional cost of different kinds of buildings or plant has not been uniform but the administrative problems of computing additional allowances upon a more precise basis would be formidable and a greater degree of precision than that given by having one factor for each year from 1939-40 and one factor for all plant installed before that year is hardly necessary or worth the extra work involved.

27. The Federation suggests that additional allowances on the lines proposed might be continued from year to year so long as there is a material difference between the normal allowance based upon the original cost of plant and an allowance based on the current replacement cost.

28. The fall in the value of money gives rise to a similar problem in respect of the capital invested in current assets, such as stocks of raw materials and finished products and work in progress. It is normal to value these current assets on the basis of cost or market value, whichever is the lower, but with prices steadily rising the cash outlay required to replace stocks is always more than the amount charged in the trading account as the cost of the stocks consumed or sold. In this way stocks valued at £20,000 today may be physically equal to stocks valued at £10,000 a few years ago, even though the whole difference (£10,000) has been charged to tax as a profit. This difference is not a true profit in the sense of being available either for distribution or to be paid in taxes.

29. The main difference between the effect of inflation on stocks and its effect on fixed assets, such as plant and machinery, is that in the former case the full cost of replacement has to be incurred from year to year as stocks are replaced, whereas in the latter case the full cost of replacement may be deferred for several years. In the case of plant and machinery the problem is centred around the deduction for depreciation, whereas in the case of stocks the problem is centred around the charge for stocks consumed or sold, or, what is in substance the same point expressed from a different angle, the valuation of the closing stocks at the year end. In the case of fixed assets the deficiency in the deduction for depreciation could continue for many years after construction costs have ceased to rise, and the problem in fact persists until all the old plant has been replaced at the higher cost. In the case of stocks, however, the problem for the current year disappears soon after costs have stopped rising, the time depending on the duration of the stock in question, and it may be said that the full burden of the inflationary effect upon the computation of profit has, at that stage, already been borne. For this reason, various devices designed to eliminate from profits the inflationary element included in stock values are of little effect if they are not put into force until after prices have already risen to their probable peak levels.

30. There are various methods of valuing stock which, by and large, enable the current cost of replacing stocks to be charged in the accounts instead of the original cost of stocks consumed or sold during the year. One method or group of methods is to base the valuation of stocks upon the Last In First Out (LIFO) principle. If, however, prices have already reached their peak or are near to it, the introduction of such a method today would give no benefit to the business concerned. Indeed, if prices fall the adoption of this method of valuation will bring out a higher profit figure than the accounts would show if they followed the normal "cost or market value" method of valuation. For this reason the adoption of the LIFO method of valuing stocks cannot, at the present time, be advocated as a universal or compulsory rule. Nevertheless, as conditions vary from industry to industry there is a strong case for allowing the taxpayer to choose

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whatever method of valuation (including LIFO or the base stock method) he considers to be appropriate, provided the method represents sound commercial practice for the industry. Having regard to the circumstance that no taxpayers in this country were allowed to adopt a LIFO basis of valuation during the period of rising prices since the war when for tax purposes it would have been much to their advantage, it would be inequitable to impose the condition that if a taxpayer chooses now to adopt a LIFO method of valuation, he must be required to continue such a method for ever even though it may be seriously to his disadvantage.

If and when prices fall, provisions made by a taxpayer in his account for LIFO adjustment and allowed for tax purposes would, of course, be brought back into profits and charged to tax as no longer required.

31. The Federation understands that it would probably be possible to allow the taxpayer to adopt a LIFO method of valuation without any legislation as this could be done as a matter of administrative practice under the existing law, but if there is any doubt on this point specific legislation allowing the option should be introduced.

32. The problem of the absorption, during a period of rising prices, of additional money capital to maintain the same volume of resources and the same level of production and trade applies logically to all other forms of current assets, and theoretically an allowance should be given in respect of such assets. For example, the amount of working capital which has to be tied up in debtor balances will, other things being equal, be double when prices are double. There are, however, certain offsetting factors, e.g. the true weight of creditor balances and long-term loans due by the business will be smaller in real terms if the value of money has fallen. For this reason, and, because of the impracticability of working out a comprehensive scheme which does not go too far, it is felt that relief should be concentrated upon the reliefs already proposed above, i.e. (a) an additional allowance in respect of buildings, plant and machinery, and (b) an option to adopt certain bases of valuing stocks which are not allowed at present. Only where inflation has reached such lengths (as, for example, in Germany) that a reform of the currency and the rewriting of contracts between debtors and creditors, in terms of the new currency unit, have become necessary, would it be practicable to adopt a comprehensive scheme in which all possible inflationary effects upon the determination of profits could be eliminated. Except in so far as this matter is covered by the proposals in the following paragraphs dealing with the more general reliefs related to past years, the Federation does not propose that any action should be taken in respect of assets other than fixed assets consisting of buildings, plant and machinery and current assets consisting of stocks of all kinds and work in progress.

33. The second problem is to determine what should be done about the erosion of capital in past years owing to the application of taxation rules based upon the fiction that the value of the currency is stable when in fact it has been falling in real terms. Because the fall in the value of money has not been recognised profits have been overstated and overtaxed for a number of years and real capital has been eaten away.

There are two matters which might be specially considered in order to give some relief in respect of past years. One is that the option to adopt LIFO or base stock as a method of valuation should be made retrospective to the beginning of 1949, during which year the Tucker Committee on the Computation of Profits was set up and the Federation made representations on the subject. Since 1949 there have been considerable increases in the cost of replacing stocks and it would be reasonable to allow industry relief from the date upon which it first made representations on this subject. The second point relates to the balancing charge or allowance in respect of buildings, plant and machinery. In Paragraph 25 it was suggested that in order to arrive at a fair measure for the balancing charge or allowance, notional additional allowance should be assumed for the years prior to the year

in which the additional allowances were granted. This would be equitable if we were concerned only to get right the computation of profits in current years. Industry has, however, been so denuded of its capital because of the inadequacy of allowances in past years, that it is a matter for consideration whether the balancing charge or allowance should not be computed without bringing into the computation the notional additional allowances which would have been given for years prior to the introduction of the additional allowances. These notional additional allowances represent the amount by which the proposals advanced in Paragraphs 23 to 32 fall short of giving relief on the difference between the historical cost of plant and its ultimate replacement cost. To permit balancing charges or allowances to be computed without bringing in the notional additional allowances into account, would grant a substantial allowance but the whole cost of it would not fall upon the Exchequer in any one year but would be incurred year by year as existing plant is replaced.

There is one factor, however, which needs to be borne in mind. As certain enquiries by the Federation have indicated, the great absorption of resources into working capital for current assets because of rising prices has denuded many concerns of the funds which they need for replacing plant and machinery. These concerns are therefore now faced with the serious problem that the money which might have been available for the replacing of plant and machinery as a necessity has been used up in working capital already and so these concerns will experience great difficulty in obtaining the financial resources they need for the replacement of plant and machinery as it becomes worn out or obsolete. This is becoming a very serious problem for large sections of British industry and relief in respect of current and future years will not go very far towards solving their problems. For this reason it is felt that the greatest consideration should be given to the relief from tax of undistributed profits set aside for the maintenance of productive capital. There is a strong case for special relief from tax in respect of sums which are thus permanently set aside for non-distribution, where these sums are required to maintain intact the true productive capacity of the business. If, however, it is felt that the determination of a satisfactory criterion for the granting of relief to these reserves would raise formidable administration problems, an alternative course would be to grant some measure of relief to all industrial profits which remain undistributed. On this matter the Federation's case for the abolition of Profits Tax is particularly relevant.

34. The Federation recognises that this whole subject of the effect of inflation upon the determination of profits is exceedingly difficult and while it sets out above specific proposals to deal with this subject, it would welcome any measures which would give British industry substantial tax relief in a situation which is becoming increasingly difficult and serious for the country's economy.

35. The argument is often advanced that to pay regard to inflation in computing profits would be to give preferential treatment as against the taxation of other forms of income. This argument is sometimes taken too far. Those taxpayers charged to tax on gross income do not experience the particular distortions which profits suffer as a result of the change in the value of money, since there is, in such cases, no question of calculating income in the form of balance of profits or gains; it is in the calculation of the balance of profits or gains that distortions arise because the expenditure charged may be at price levels which differ substantially from those ruling for the inclusion of receipts. In so far as this would confer an advantage it must be remembered that unless industry's position is rectified, at least to the limited extent proposed, all taxpayers will eventually suffer very much greater hardship than at present, owing to the erosion of industrial capital residing in the inability of industry to support the national economy.

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EXAMINATION OF WITNESSES

4660. *Chairman:* Mr. Chambers, the position is, is it not, that you have already been before us and we have asked you many questions on general topics. In particular, you have produced this case study of 80 companies, and you are familiar with certain comments and criticisms which have been produced on them?—*Mr. Chambers:* Yes.

4661. I do not want to suggest that because there are comments and criticisms there is no value to be extracted from it, but there are comments which the T.U.C. have provided and the Board of Inland Revenue have provided, and you have had a chance of reading both of those?—Yes.

4662. I wonder if, quite shortly, I could ask you what your view is about one or two of the main points. First of all, in taking the 80 companies you have told us that you have taken a wide sweep of industry?—Yes.

4663. You have embraced large, small and medium businesses?—Yes.

4664. Is there, according to your knowledge, a preponderance of any particular section of industry in the 80 companies?—Perhaps if I explain how they were chosen, that would help. I think, very briefly, I ought to say that this enquiry did not originate solely or even mainly as a taxation matter. We were concerned at this time, this is way back in 1950, with several other aspects, and Professor Hicks indicated one or two of them a little earlier this morning. We were concerned with industry maintaining its resources; we were concerned with its price policy and we were concerned with its dividend policy; we were also concerned with various suggestions that profits were too high, when we felt that in many cases profits were too low and profit margins were too low. There were one or two cases that I could give as illustrations, where the price control was so low that it was unprofitable to put any new capital into particular products which were absolutely vital to the country. Those were the main purposes in our minds, and not the taxation aspect. I can say as a general point that the panel which drew up this questionnaire and dealt with it was not the taxation committee of the F.B.I., it was a special panel from the economic policy committee. It was not, as I think some persons have suggested, merely a document to try to prove a pre-conceived case.

For that reason we (I say "we", I was a member of the committee, but not its chairman) we went through the trade classifications and took a number of cases from each of fifteen classes. The total number of cases which were circulated was over 200, and of these some failed to reply because the work we asked them to do was very onerous indeed; as Mr. Bird has explained, the figures of published accounts have not much value, you must go right behind them and get particulars of the year in which plant was bought, and the basis upon which the depreciation allowance was charged, and so on. Some people gave answers in a form which was impossible to add up statistically, they gave verbal answers which you cannot add up. In other cases they found it quite impossible to give the information in the form which was asked for. It was necessary in the case of very large companies to exclude overseas assets, overseas subsidiaries, but to include home subsidiaries, and questions of distribution of profits are extremely difficult when you have joint companies and overseas companies all mixed up.

Although we are keeping all the information confidential, as a matter of arrangement with the companies included, it is no secret, I think, so far as my own company was concerned, Imperial Chemical Industries, that we thought we could do it, but we found in the time available, because the company was in the earlier years, in 1938, organised as a number of manufacturing companies, in the later years as substantially a manufacturing company and not an investment company, that it was impossible to get those figures out in time, in the form that was required. Therefore we got the figures from a limited number of these companies, and then the number that could be classified and brought together amounted to about 80.

It is natural that some of the larger companies were able to do it, and some of the smaller companies just

did not have the staff to do the work, but it is true that of those who did it they spread over the whole of the fifteen groups of the Board of Trade classification of industry. It is also true that the numbers include large companies, medium-sized companies and small companies, all members, of course, of the Federation. It is also true, I think, and this we have quite clearly admitted, that as some of the large companies are very large, and this is a small sample, however we arrange the figures their position tends to dominate the totals. We realise that. I believe in fact if we take the figures for the smaller companies separately, and we tried to do that without disclosing figures, we would find substantially the same general trend for each of the trade classifications for which there was more than one case.

Our intention was to try to get at the facts in order to demonstrate to some companies that perhaps their dividend policy was wrong, and to demonstrate to certain Government Departments that a price policy which followed depreciation based on historical cost, was doing great damage in certain parts of industry.

What we are hoping to do is to extend this sample to a much larger number of companies, and to bring in the results for 1950 and 1951. I fear that as it is being done by the F.B.I., however well the work is done, and however objectively the work is done by the staff of the Federation, it may not appear to be an unprejudiced sample, or the results may appear to be biased. That is not the intention, but if there were any independent organisation which was prepared to do this very difficult work, and to do it really thoroughly, I am quite sure they would have the full support of industry, because we do regard it as an extremely important matter.

4665. It is. Does that mean that this extension of the figures, both in time and to a wider range, is going to be made available to us?—That would depend upon how long you were sitting. The companies concerned have a lot of work to do.

4666. I know.—And I believe some of them would take a long time getting out their figures. Then inevitably questions have to be asked on methods of valuation, and queries have to be cleared up.

4667. *Professor Hicks:* Would it be possible for you, as I should have thought it would be, without much difficulty, to give us a weighted average of these figures, or rather, unweighted, as one might say, by simply reducing the net assets of each company, say, to £1,000, working the figures for each company on that basis and then adding them up? By that means you could remove the suggested bias of having too many large companies in.—Yes, statistically that is possible. It is a very interesting suggestion, and it would give the trend without giving too much weight to the large companies, that is true. We did not do that; I think if we had done that we should have been accused of manipulating the figures.

4668. *Chairman:* Now you have had a specific request for it.—May we take that into account?

4669. Can you do it without any great expenditure of labour?—I think that would not involve very much work. That is merely an arithmetical exercise which could probably be done.

4670. I see. Now, your valuation of fixed assets as at 1949: one method brings out £304 millions, one £356 millions, one is a little less than the value given to the fixed assets in 1938, and one I think is 13 per cent. more. One criticism that the Inland Revenue have thrown up of the figures so arrived at is that they both depend, as undoubtedly they do, in one case on taking the actual depreciation appropriations made over a period of years, that is, the actual appropriations made between 1938 and 1949, in order to reverse the returns of 1949, and in the other case a computed depreciation assuming that the replacement cost is £785 millions; they say it is very difficult to be sure that the allowances in fact made have been what may be called scientific: they may have been over-generous and that may produce a possible major distortion of figures. Do you regard that as a fair comment?—It is always difficult to get a depreciation rate which will write off the asset over what turns out ultimately to be the real life of the asset, but when you take

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the factor of obsolescence into account, as well as of the depreciation, and obsolescence is extremely important, the longer the period that is covered and the larger the number of cases, the smaller I think is that particular factor. I think it is fair to say that this kind of point might account for the difference between the two figures, but not very much more than that. It would not be of a very large order of magnitude, I do not think it would be very important. What we have done is to take each year separately, and taken the actual additions and the sales of assets year by year for each company, and to take their actual depreciation and then to write it up again or write it down, according to these indices.

4671. In your first method you take the additions, minus the assets that have fallen out, and you take the company's appropriations for depreciation, which represent reputed wastage of capital, but you will agree there is some element of uncertainty when you make your calculations on the depreciation figures allowed?—There must be. In the long run, if you had more years the early assets would fall out, and this factor would become of diminishing importance; it must do.

4672. Yes. Then the other method which brings up £356 millions, there you are necessarily dealing with estimated figures from the beginning?—Yes.

4673. You look at your assets as they all stand in 1949, and ask yourselves what, in terms of the prices of that year, would it cost to re-create them afresh?—Yes.

4674. And you would agree there must be a very large element of uncertainty?—There is an element there, yes. I would say, as I mentioned earlier, if anybody can take the real figures, exclude all the irrelevant figures, and get at any answer which is substantially different, having got at the facts instead of dealing with generalities from balance sheets, we would welcome the opportunity of seeing whether the point is of importance or not.

4675. I then wanted to ask you (on the figures which those two methods bring up, the best attempt you can make to give a 1949 value) is it not very strange to find the number of the employees of the companies concerned has gone up by the amount that it has, 35 per cent., and the turnover is so enormously increased, if the assets have not in fact considerably increased?—It is puzzling. I think there are some factors which account for it. It would need a good deal of capital analysis of the particular cases to see why the number of employees has risen, and why the turnover has risen. May I mention two factors which clearly must have an influence: one is that the general utilisation of labour

in the later years, its productivity per annum, not necessarily per hour, was lower in the later years than in the earlier years. There was a shorter working week introduced just before the last two years; the average number of hours worked was less on the whole. There was more employment of part-time people, married women and the rest, and the work done per employee, this is no disparagement, I think must have been less than in the earlier years. Some of the companies no doubt took over other businesses, or parts of other businesses, and they would have brought in more employees; that is a difficult factor to estimate.

On the question of turnover, here there is a factor which is likely to have affected the figures materially. Some of the companies included (I am not at liberty to give names, and I am in some difficulty for that matter) dealt with commodities on which the rate of duty is extremely high, and that rate of duty is much higher in the later years than in the earlier years, and I am personally conscious that that figure of turnover at the end is inflated by duty included in the turnover which was not in the earlier figures. Of course, when you are trying to compare turnover with fixed capital, you get an inflation of your turnover if you add such matters as duty, the various sorts of excise duties, whereas you have no increase in the real productivity. That accounts, I think, to some extent for this increase in turnover in the later years as against the earlier years.

I believe if we could exclude certain companies, and give figures for companies where there is greater comparability, the shortage of real assets, of fixed assets and stocks, would become clearer, but we have not liked in this thing to do other than to give all the figures that could be classified in the form in which they have been produced to us. We did not wish to manipulate them and take out some cases that happened to be unfavourable to us, or anything like that. We thought it was unwise to do that.

4676. Even allowing for possible elements which go to explain the increase of employees and the great increase in turnover, your own estimate is that these companies are doing one-third, and perhaps more, more production than they were doing in 1938.—Whether the increase in real production is as much as one-third I think is questionable. Personally I think it is probably rather lower, but it is one of the difficulties of interpretation.

4677. I thought from your case-study that was what you were saying?—It is, but on looking at the figures in the light of the comments that have been made both by the T.U.C. and the Inland Revenue, I think in fact the true turnover is rather less, but a further analysis of the figures would perhaps give us a truer result.

At this stage the proceedings were adjourned for lunch.

On Resumption

4678. Chairman: Mr. Chambers, I think when we broke off I was dwelling on these points as illustrating the figures which have been arrived at for 1949.—Mr. Chambers: Yes.

4679. I am still a little puzzled about this question of the rise in production which has come as a trend since 1938. You say there may be reason for thinking that is a bit high, but if you do not allow whatever rise which has been achieved as being due to more intensive use of equipment, when you say the possibilities of that are limited, how can it not suggest that there is considerable increase in real assets?—May I say at once that in my own mind I believe that there has been more intensive use of equipment in a certain sense. If I may explain, the sense not necessarily that there has been a wonderful improvement in productivity as a matter of industrial efficiency, but that between 1938 and 1949 because there was a state of full employment factories were working flat out. I know this as a matter of personal experience, they were working at 100 per cent. capacity, and in some cases at over 100 per cent. of rated capacity. In that sense there was greater use of the equipment, in that sense certainly, but not in the sense that they were more efficient, rather that instead of working 80 per cent. or 75 per cent. they were working at 100 per cent. That has been true of a number of factories that I know of, and it must be true of others.

4680. Let me see if I can follow you. Supposing you have a machine that in the old days was actually in use for 8 hours in 24.—Yes.

4681. And then by taking on a lot more employees you in fact used it if you could for 24 hours in 24 by three shifts. Would you call that a more intensive use of equipment, or not?—Yes, it is a more intensive use of equipment. The other kind of increase is where you have a factory with a number of plants, or a number of pieces of equipment where you expect to have one out of use for maintenance and cleaning up and tidying. In 1948 and 1949 in many cases the whole lot were working, and I know cases where they have said, "We cannot go on for ever doing this, sooner or later we have to stop." The use of equipment in that sense was more than normal. That is quite true of a number of factories, there is no question about that I think. I know of specific cases. It is true, therefore, that the state of full employment meant that all capital equipment was more fully used, but that does have another important bearing on this problem, and that is that if you have a country in which all the equipment is being used fully, and you have no real chance of changing what you are doing, the system is so tightly stretched that you are unable to bring in improvements. In the United States of America it is so much easier, we know this from our own experience, to scrap a plant and put up something new because it is

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more efficient. If you are working everything full out, with capital control of money, you carry on with your own way of doing it, and this whole question of obsolescence has to be put into the background, and that has been happening in British industry. To this extent I would like to modify the expression "we do not think it is very much due to the fuller use of equipment".

4482. You say for advances in technical efficiency you need some play in hand?—Yes, you must have it. If you do not have it the whole system is over-deterred. For one thing you cannot do it, and secondly there is no incentive to do it.

4483. There is another thing which your calculations of the value of fixed assets throw up which was a surprise to me, and I would like to hear what you say about it, because it affects the figures. You say that in 1938 on average and taking 1949 prices there were £623 of fixed assets per employee and in 1949 only £449 of fixed assets per employee. They are the figures in your paper.—Yes.

4484. On my expectation of what would have been the movement in industrial equipment between those years that is a surprising result, because I should have expected to have found it the other way.—Yes.

4485. Does it not surprise you?—On the whole, no, because I think the increase in numbers of employees has been so much greater than the increase in real equipment. The number of employees because of shorter working hours, the employment of part-time married women, have increased more than the value of true equipment. I think the drop is more than I would have expected, but that there should have been a drop is not a surprise.

4486. I follow what you are saying. Do I equate employee with productive worker, or overall?—Overall.

4487. Because there would have been possibly a considerable increase of non-productive workers in the industrial organisation.—Even those who are employed on tax work count as productive employees.

4488. I am passing on to another comment which has been made, I think in both the memoranda we have read, that is a comment upon the distribution policy which may have been followed by these companies that you studied over the relevant years. It is suggested, if we have understood the figures that you have given correctly, that a rather high level of distribution policy had been followed in regard to the average experience of dividend-paying contracts. Have you got any comments you can give us on that?—Yes, I would say that if companies kept their accounts in the way in which I think they should keep them, and segregated that part of their profit which was really needed to maintain the real capital, both fixed and floating, then there are many cases in which they have distributed more than they should have done, but, at the same time, the amount that they have distributed in real terms in the hands of the recipients is less in 1949 than in 1938.

4489. In real terms?—In real terms which suggests that the profit margin is too low.

4490. Over these companies whose accounts have been looked into for this purpose, do you not find that, quite apart from tax calculations, they have themselves been aware of the problem of maintaining real capital in their estimate of distributable profit?—I think the short answer is whether they have been aware of it or not their own provisions for depreciation have been too small. I think the figures show that; I think it is all in Table II of Appendix A; it shows the total depreciation provisions they have made to date £188 millions whereas they ought to have made £476 millions and that currently in 1949 they made £19 millions when on the basis which I think is the soundest basis it should be £49 millions. I think it is fair to say that there has not been adequate appreciation of this problem.

4491. That is a calculation which I think you went us to dwell upon?—Very much indeed.

4492. £283 millions is the computation of the right figure for the renewal of the 1949 assets, and £427 millions is the cumulative provision which ought to have been made by that date?—Yes.

4493. To be ready for renewing them when the time came?—Yes.

4494. You contrast that with the figure of £189 millions you have been calling attention to, which is the actual provisions which have accrued at that date?—Yes.

4495. A difference of £238 millions?—Yes, I think those figures are very important indeed.

4496. The only comment which I have noted with regard to that is that the £189 millions is said to be an accumulation of £6 over a period of years, all those years when the £ was progressively depreciating in its purchasing power, and you contrast it with a figure of £427 millions which is said to be the figure you require, and I am not quite clear whether it is. What do you say on this?—I would say this, if in fact, this is an admission on these figures, if in fact the £6 had been set aside in cash or in some claim of money which depreciated with that money then the position would be quite as bad as is indicated by the comparison of the £188 millions and the £426 millions. It, in fact, a substantial proportion of that had been invested in assets of one kind or another which appreciated in terms of money to that extent, the difference is not so large as appears from those figures. I think perhaps a more significant figure is the figure that follows, the depreciation provision made in 1949 against what ought to have been made in 1949.

4497. In so far as the theme is rather financial tightness, owing to the combination of these factors, I suppose the £189 millions would have tended to be put not into money assets but into real assets?—The tendency I think, the statement and the figures being this out, was that they got put into money and money assets up to the end of the war, and so that extent there was this real loss. Since then more of it has been put into real assets. I think the figures in the beginning of Appendix A clearly indicate that that is what has happened.

4498. There was only one more question I think I wanted to put to you arising out of these various comments. In paragraph 25 of your case study you distribute the increase in the total assets of the company over the 1938-1949 period, £362 millions, between various sources from which that money has been found.—Yes.

4499. And you distinguish the £199 millions which has come from retained profits from the £163 millions, the balance, which has come from new money in one form or another.—Yes.

4500. There is only one element in the new money, it is a very big one, which has been queried; that is the figure which you call "Increase in tax reserve for subsequent years liability and deferred liabilities." I think I can probably get straight what that is: that is money which is retained in any one year because of the profits made in that year to meet the tax which is going to be paid on them in the following year?—Yes, it is that plus also any reserve which may have been set aside because of the tax advantages due to initial allowances. The tax bill goes down in the year in which you incur capital expenditure, and it is the practice of many companies to set aside that tax advantage because they will have to pay extra tax later on so there may be some element of that included also in the £55 millions.

4501. In so far as you do find your additional assets from that source you are really claiming the amount and borrowing from the business itself, are you not?—Yes, that is true. What you reckon is that £55 millions must be paid in cash in taxes, and so that extent if you put that into fixed assets you are laying up trouble for the future.

4502. On the other hand, if you go on year by year making as high a level of profit, you will find that each year you can renew that?—That is perfectly true. If without fail the business goes on doing that and continuing to make larger profits it snowballs in the sense that you will always have a lot of money to pay your tax out of the next year's profits.

4503. In that sense it is a form of retained profits, is it not?—Yes, that is quite true.

4504. Mr. Milford Tucker: When you were last here, I am speaking now about the current year basis of assessment.—Yes.

4505. When you were here last I asked you if you would, in this forthcoming document, give as far as possible all the reasons you could think of why you

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thought our first Committee was too timid to recommend the change to the current year basis. Your comment on the Report of the Tucker Committee, paragraphs 4 to 14,* represents the whole of everything you can say on the subject, does it?—Yes, I am not sure whether we have dealt with this matter that you now refer to in our new evidence. I think we have slipped up, I think I am looking at the wrong document.

4706. If you will look at your document dated February, 1952, the one which comments on the Report of the Tucker Committee on the Computation of Trading Profits.—Not the one we have just given, the subsequent one.

4707. This is the one which I gather you promised was coming?—Yes, that is true.

4708. I looked up the Minutes of Evidence to see what was said about this and I will just remind you. I said: "In your current paper can I ask you to deal with the difficulties without fail that we put forward?"† and you said you would. I indicated to you that in our Committee we started with a strong predilection for changing over.—Yes.

4709. And regretfully came to the conclusion that we could not really recommend it.—Yes.

4710. Paragraphs 4 to 14 are all you can say on the subject of the difficulties that we were putting forward? I do not mean to say it in a disparaging sense, it represents the whole of your answer?—Yes.

4711. There is one thing you did not deal with in it. You see, the National Union of Manufacturers which is a body whose word carries some considerable weight, they represent mainly the smaller people, whereas you, I think, represent a great many of the larger ones?—Yes.

4712. One of the great objections of the National Union of Manufacturers was the objection that small taxpayers who have not a permanent taxation staff, and cannot afford, many of them, very expensive accountants, would not want to have two or three bites at one cherry. You do not deal with that, do you?—I think in paragraph 7 where we are dealing with the difficulties arising from provisional assessments we have suggested that the difficulties have been over-stated, and I wondered whether I might just point out that for the small business under the present provisions there are adjustments either to the actual income of the year or option to the actual income of the year in each one of the first year, the second year, the third year, the final year and the penultimate year to the final year, those five years. My own experience, looking at a large number of industries, this is when I was in the Inland Revenue, was that the average life of a small business is much smaller than is usually imagined, because a change in partnership counts as a new business for this purpose, and that in practice for the small businesses these adjustments are made in more than half of the number of years involved, probably two thirds, it depends upon the nature of the business, and I feel that the immense difficulty in dealing with the present system for the small business is perhaps to be balanced against the fact that they would have a provisional assessment based upon the actual income of the year in every case for all businesses. I should have thought that to make a provisional assessment and then pay the tax on the final income of the year at the end of the year is simpler and does not require a lot of expert taxation knowledge. Indeed, I would say further that it requires less expert knowledge because the present rules require a very skilful judgment of the option, whether you should take the option or should not take the option according to your problems in the second and third years. I would say that our proposals are in practice simpler and easier, and in this I would quite definitely disagree with the National Union of Manufacturers.

4713. I have heard what you say, but my recollection is that there were roughly about 1,400,000 assessments, about 200,000 of those were partnerships, about two hundred thousand-odd were the larger concerns, and the remaining 1,000,000 were the smaller people.—Yes.

4714. I am one of those 1,000,000, and I have never had a discontinuance claim or anything of that sort of thing. Speaking for myself when I sign my annual return and I get rid of the distasteful document I hope I will never have to trouble with the thing again, and there must be a great many other people who do not want

to have three bites, as it were, at the cherry.—If I may say so with respect I think the legal profession is in a particularly privileged position. It has very special tax advantages which I think are accorded to nobody else except possibly underwriters at Lloyd's.

4715. Not until we are retired.—You, I think, have the advantage of putting in your cash figures and leaving everything else out. I think if I may say so that the illustration is not a very fair one, and I think if we were allowed to go on that basis we would jump at it.

4716. Now, Mr. Chambers, just let us be serious for a moment. You say it is not a good one. Take an ordinary little grocer.—Yes.

4717. I suppose that would be a fairly acceptable one. Do you think he would like to have to make three attempts at getting his final liability for the year settled?—I would say, and I say this seriously, the number of assessments that are required in any event in every case, personal cases, is so considerable, it is such a large number, that this which we are proposing is relatively small.

4718. According to the figures which we were given there were over 1,100,000 annual assessments of individuals alone, not partnerships.—Yes.

4719. And of those about 250,000 were farming assessments.—Yes.

4720. There is nearly as much work in a small case as there is in a big case for this purpose of current year provisional, and then second provisional, and then the final assessment, and so on, is there not?—Yes, but may I say that if you look into that particular case and ask what extra work is involved I submit it is this. There is the provisional figure which is submitted by the taxpayer and on which the assessment is made. There is no substantial work involved in that. Then he sends his account in at the end of the year, and the final figure is determined in the same way as before and the account is adjusted. I think that it is a relatively small operation.

4721. This document of yours was not in preparation when I asked you on 1st November, 1951, if you would be good enough to deal with all the difficulties, the practical difficulties that we have raised. I do not see a single reference in this document to this question of the amount of extra work for all these one million-odd individuals. Is it simply that you think it is so small a point that it is not worth mentioning, or do you think the answer you have just given is a satisfactory one?—May I say how sorry I am if we have not dealt adequately with this point. In paragraph 7 I think we intended, perhaps we have put this too briefly, to indicate that the difficulties which were suggested in your Committee's Report arose to a very large extent, and the examples indicated that they arose, from trying to get an exact determination of an estimate instead of dealing with a simple estimate which would not require doubling the work. We have said that in paragraph 7. We said:—

"Indeed these examples, based upon the conception that there must be an exact legal determination of the provisional liability on a statutory basis to be laid down, suggest a lack of appreciation of the function of the provisional assessment."

I think that is the crux of our answer. We say if you get away from wanting an exact determination and get more to the provisional payment on account which happens in each of the five years which I have mentioned, certainly each of the first three years, if you then pay on account what is approximately right, then I would suggest that a large number of the difficulties have been overcome. I apologise if our paragraph on this has been perhaps too cryptic.

4722. Yes, it does not concern the companies with large taxation staffs. It does concern these small people who have quite a big enough job to make up one return, have they not?—Yes, we had it very much in mind. I had personally very much in mind the smaller case, because you made it very clear yourself, that it was the small case which troubled you and we had that in mind when we wrote this; we had that in mind and not the large case.

4723. That is all I want to ask you because you have made the replacement cost point quite clear. You seem

* Not reproduced in these Minutes of Evidence.

† Minutes of Evidence, Day 4, Q. 1052.

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to be all standing on the same ground.—Yes, may I just add one point on that, that is that if we have given the impression that we base our case solely on industry's difficulty in getting adequate capital, if we appear to have done that we have given perhaps a wrong impression.

4724. No, you put it quite clearly, you have divided it up into two problems: the first problem is the deduction of the depreciation based on the current values of the assets.—Yes.

4725. That is what I call the problem of ascertaining the right amount of tax?—The right amount of income.

4726. Tax payable; and the second is merely by way of emphasis, that because of what has been done in the last twelve years you are now, as a result, short of money?—Yes, that is quite true.

4727. I would have thought that the second problem was partially met by the initial allowance.—Yes, partially met.

4728. Perhaps to quite a considerable extent it is met, but it does not meet the first one.—No, the problem of determination of income is, we feel, an extremely important matter.

4729. So far as it is a question of the second problem, that is the financing, it is a question of timing there, is it not? You want to build up the amount of money you need by a reduction in the taxation which is being levied while the asset is being used and worn out?—Yes.

4730. The initial allowance will not give you that amount, or whatever part it does give to you, until you actually spend the money?—Exactly. That, if I may say so, puts it very clearly, that we feel very strongly that accounting on a current cost basis to get at what we regard as the true income of the year is a sounder method of achieving what is substantially the same result.

4731. Mr. Carrington: Just one point on this old bogey of the basis year and your answer to Mr. Tucker on that. Do you visualise that the Inland Revenue would have the right to see for tax on the provisional assessment?—Yes, in the same way as it has the right to sue on the estimated liability in undetermined cases at the present time where necessary. It would be a very small proportion of the total number of cases which would require a formal determination of the General Commissioners.

4732. I put that question because the Board stressed very considerably in their evidence to the first Tucker Committee that it was doubtful whether the community at large would support legislation giving a right to sue on an estimated assessment.—If I may say so, there is already the right to sue where there is no determination except on the amount which is not in dispute. They can sue for collection of that tax, and I imagine what would be necessary is, in those few cases where it was impossible to reach agreement as to what was the minimum liability, you would have to have a formal determination by the General Commissioners and sue on that.

4733. It is slightly different from the present problem, because you say, "What is not in dispute." That would not be quite sufficient, would it?—If a taxpayer claimed that in the current year he was making a loss, and if there was reasonable evidence that he could adduce to show that there was a current loss I think there should be no right to collect tax on any provisional basis in such circumstances.

4734. The field for the Commissioners to determine it would be wider than it is today?—That is right.

4735. One more point, and only one, on the question of inflation and current cost accounting. Do I gather that the F.B.I. lay equal stress on fixed assets and stock, or do they place more on one than the other?—I find that a difficult question, because the Federation represents so many different bodies, and some constituent members and constituent bodies were quite clearly placing much more emphasis on one than the other. If you take shipping, there quite clearly the fixed asset problem is much more important. Therefore if I am asked to say do I weigh them approximately equally as a Federation it is difficult to say. If you ask me personally, which is a fairer way of putting it, I would say they were both extremely important.

4736. The reason I asked was, rightly or wrongly, I read your comment on the Report of the Tucker Committee as being a little bit in the nature of playing down on the stock point. I want to be clear whether my inference was right or wrong. I have in mind paragraph 29, and my note at the side was "playing down stock". I would like to know whether I mis-read the underlying sense of that paragraph?—I think it is fair to say that you have not mis-read the underlying sense. I think we would say that the damage is not having stocks on a current basis but very largely been done in the past. We would like to have that damage remedied if possible, but is getting at what is true income from now onwards there is less room for movement in the stock position than there is in the fixed assets where there are old fixed assets still running, and therefore if you run into a state of affairs in which prices are going generally to decline, as a matter of practice but not as a matter of principle, the stock point becomes less important.

4737. Chairman: One question on that. You do not regard either question as involving a different principle, do you?—No, we would say the same.

4738. Both claim current costs as a measure of consumption of your capital?—Entirely. We would argue that historical cost whether for stocks or for fixed assets is entirely irrelevant in determining income for the current year. I think every economist would agree that from the point of view of determining income, or determining how you use current resources, what happened five or ten years ago, how much you paid or how little you paid is irrelevant. It is the current use of current resources, and the possibility of using one thing rather than another which is important, and that applies equally to stocks as it does to fixed capital.

4739. Mr. Crick: Regarding your Appendix A . . . ?—On the inflation document?

4740. The summary. I wondered first whether your trade creditors have been set off against your debtors for this purpose. I assume that is the only thing that can happen?—I think the item "less current liabilities" under the expression "current assets" would be the creditors.

4741. I see, that is what you have got there. Your gilt edged, where would they be? In your cash assets or in your investments?—The gilt edged would be in "cash and cash assets".

4742. I have been doing a little calculation on the liquidity of these accounts. Would you attach much importance to the maintenance of liquidity in a business having regard to the hazards to which business is subject?

—I would very much, and I would say that what has happened, as I see it, is that resources which were set aside as reserves for the replacement of the fixed assets, plant and machinery, have been used compulsorily in the acquisition of current stocks, at higher prices, and as a consequence many businesses are becoming very illiquid and when they are due to replace fixed assets will have great difficulty as doing so. I believe that all the figures, the bank figures as well, indicate that this has been happening and will continue to happen on the present basis.

4743. I think on these figures one gets the impression that between 1938 and 1945, speaking in terms of pounds without any adjustments, the liquidity position improved markedly?—Yes.

4744. I say in pounds.—Yes.

4745. Between 1945 and 1949 it deteriorated rapidly?—Yes.

4746. Over the whole period it looks as though what you might call net liquid assets were in pounds about twice as big as in 1938?—Yes.

4747. In pounds.—Yes.

4748. Would you have said that in 1938 business was reasonably liquid?—I should have thought that it was reasonably liquid, and that what happened was that with the inability to replace plant and machinery money was put into Government securities, kept in balances of one

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kind or another available for the replacement of plant after the war, and that therefore as one would expect the figure for cash and cash assets in 1945 was much higher than in 1938, and that after 1945 as the position deteriorated prices went higher and as some rebuilding took place the cash dropped to an unhealthy low level. I think that, read with figures which have been produced in other places, it suggests that this liquidity has fallen further still since 1949.

4749. That position of liquidity, such as it is today, has on these figures been maintained by virtue of some small extent of the injection of new cash capital?—Yes, but mostly. . . .

4750. But mostly by the accumulation of reserves out of current profits?—In 1945.

4751. What your proposals would aim at would be that that degree of liquidity with which one started should be maintained without either calling for new capital or for the ploughing back of profits?—Ploughing of true profits. Yes, what we aim at—may I put it this way, I think if I may say so it is the way I understand it. In every business you must have your fixed assets, your stocks, debtors and creditors and cash. It is quite impossible to run a business without these things; it is quite impossible. If one of them gets too small then the whole business gets out of balance and your profit falls, and one ought to aim at so determining the income for all purposes, whether for price policy purposes, for dividend distribution or taxation purposes that the amount required to maintain all these assets in proper proportion should be available, and only the surplus should be paid over as profits available for taxation or dividend. What we aim at is some such state of affairs in the way in which people keep their books, and in the way it is dealt with for tax purposes.

4752. You have no record, I suppose, of the amounts paid in tax over the periods between these dates?—I am not sure whether we have detailed records. I think some figures might be obtained. I do not recollect it.

4753. I wondered what the magnitude was as compared with the change in the general structure of the assets?—I am afraid I cannot give the figure, not straight away. I think it could be obtained.

4754. My last question is just this; supposing for the sake of illustration that these companies were paying, what shall we say, £200 millions in tax. Now imagine that, by adoption of your recommendations in respect of depreciation allowances and so forth from the very beginning of the period, the tax had been £100 millions. What sort of difference do you think that would have made to the picture we have in the 1949 column?—I think on the side of fixed assets you would have made comparatively little difference, because the amount spent on fixed assets has been limited more by the controls of capital expenditure than by the availability of cash, certainly up to the end of 1949, but not necessarily since. I think stocks and debtors would have been substantially the same and that more cash and cash assets would have been available for the capital expenditure since 1949, and that the figure for cash and cash assets in 1949 would have been substantially higher.

4755. They would have been in a more liquid position?—They would have been in a more liquid position.

4756. Would there have been any more paid out in dividends?—That is a very difficult question. It is very difficult for me to say whether if people had the money that they would pay it out in dividends. I feel in some cases they would have paid larger dividends, and I think that would have been a wrong policy in most of those cases. I think that is the position.

4757. *Professor Hicks:* Mr. Chambers, might I begin by just asking you one small question which is connected with what Mr. Crick was asking. The question, and I am sure Mr. Crick knew the answer, but I do not, is this. I notice in your Appendix A the investments item goes up quite markedly between 1945 and 1949.—Yes.

4758. Is there any particular explanation of that? Is it largely, though not entirely, that it offsets the fall in the cash item?—I do not think it is really connected with the cash item at all, because these include investments in

subsidiary companies, and some of them may represent the acquisition of subsidiary companies themselves. I cannot tell what that means without further analysis. I do not think it is really connected essentially with cash assets, because you do not use cash assets for purposes of this kind. This represents the change in the book value of subsidiary companies, and in so far as there has been a money inflation of the value of their subsidiary companies by the inclusion of undistributed profits whether on the right or wrong basis the figure would go up and would explain the movement from £101 to £155 millions.

4759. We have the item for investments including investments in subsidiary companies. . . .?—It is mostly in that, because in so far as there were investments such as Government securities and things of that kind which were readily marketable they would have been included in cash assets.

4760. The only other point I wanted to ask was about the other matter which has been discussed. You said in reply to Mr. Carrington that on your scheme it would be possible for the taxpayer to be sued on his provisional assessment?—Yes.

4761. What I was wondering was what he would be sued for, that is to say, how definite could the provisional assessment be made? Could his legal duties under the provision be met in order to give you something definite against which a claim could be made?—I think so, I think it would work in this way. The taxpayer would, if he claimed that the profit was less than a certain figure and the Inland Revenue thought it was larger than a certain figure—there would be a discussion informally between them on the basis of what actual profits had been made up to date before the end of the year. If the taxpayer claimed that a heavy loss had been made which had not been shown he would produce the evidence, and I have no doubt that in normal cases where there is no attempt to avoid tax it would be possible for the taxpayer and the Revenue to reach agreement as in the present cases of determining liability to pay on estimated assessments. In exceptional cases where there is no agreement there would be difficulty because all the evidence is with the taxpayer as to what profits have been made. That is one difficulty, all the evidence is with him, and it would be for the General Commissioners to endeavour to get such evidence as was available from him of his profits up to date and then to make a provisional assessment. Having made the provisional assessment all the normal machinery for collecting tax would follow.

4762. It seems to me that one is right, is one not, to lay very great stress on your clause that a rate of interest should be levied on postponement?—Yes.

4763. That is an essential condition to make the thing work. I am not really quite clear, provided that that clause is given full emphasis, why it is necessary to have even the right to sue for provisional assessment?—I think the reason would be that you would not wish that the taxpayer should have entirely at his discretion a loan from the Government at the rate of interest which is laid down in the Act. You would want to say he has to pay the interest, it should be at a substantial rate, but he should not have the chance always of getting the loss of the whole of his tax at that rate.

4764. Could not the matter be made really more simple by allowing postponement for a minimum period, I do not know, six months, say something like that, at a rate of interest which was more or less similar to the market one, and as soon as the postponement became longer make the rate bigger?—That is, in fact, a system which is operated in at least one other country by imposing a penal rate after a certain length of time; that is something which can be done. The imposition of a rate of interest is a fairly common practice. The imposition of a penal rate after a period is less common but is practicable and has worked.

4765. All that they could sue for would be effectively the final assessment rather than the provisional?—Yes.

4766. *Chairman:* Thank you, Mr. Chambers. Is there anything else you want to say on your document? I have asked the main questions, but if you would like to

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add anything?—No, but may I add one brief word on the Inland Revenue document as a whole. Very briefly, it is that the difference between the approach that we have taken and the approach of the Inland Revenue is that we wish to see income dealt with properly as an economist would understand it is so far as it is possible and practicable to get income as an economist understands it assessed for tax purposes. We believe that the difficulties are not so great as have been imagined, and we do not take the view that the Revenue has taken that income is merely a matter of saying in one year so many pounds were paid into the business and in another year so many pounds were taken out. We think that is wrong. The right approach is to say in the current year resources have been or are being used to produce something, to produce income. What is the real cost of those resources to the economy and to the particular concern? It is the real cost in the current year which is vital and important, and I would say that modern accountancy practice does recognise the importance of taking current costs against current income. I would like, if I may, just to refer you to a case in the Canadian Courts in which the lawyers took a very clear view of this, and showed very clearly that it was in their minds that any system of merely taking historical costs was irrelevant and not taking current costs was improper. The case is that of *Anascondia American Brass Ltd.*, recently decided in the courts.* It is the actual wording of the judgment as much as the judgment itself I would commend to you, because I think that that does show very clearly our way of looking at this. The other point I would . . .

4767. Which Canadian Court?—The Exchequer Court of Canada which heard this case only this month, and it does bring out the importance of trying to get at current costs, and I think that does put our case from the legal point of view more clearly than we can do.

* *Anascondia American Brass Limited v. Minister of National Revenue*, Exchequer Court of Canada, June 7th, 1952; 53 D.T.C., page 1111.

4768. That was concerned with stocks?—Yes, it was concerned with stocks, but the importance of it is that they said you really must take into account what the current costs are of producing what has been sold currently. The same principles apply to fixed assets as to stocks, and I see no difference there. From the fixed assets point of view it is as significant for non-tax purposes as for tax purposes. I could give you an illustration of a commodity in this country where because the price was controlled by reference to historical cost of plant the price of the commodity in this country was kept down to a level at which it was impossible for anybody to produce the commodity from indigenous resources, and it had to be explained to the Government Department concerned that the current price must take into account current costs of replacement, otherwise nobody would produce this commodity from indigenous resources in this country. The point was the same there as it is for tax purposes. I would stress that we are not suggesting that for tax purposes we should get some special treatment but that income should be treated properly and, as I say, soundly from the economic point of view. We are not merely presenting a case as a matter of *misericórdia*, wanting something because we must have it to keep industry going.

4769. Mr. Millard Tucker: Just one last thing. Now you have started quoting authorities did you read such reports as were available to the public of the recent arbitration of the Staveley Iron Case?—I fear that I have not, no.

4770. I commend those to you.—Was that a British case? I was suggesting perhaps in another country that these problems were looked at perhaps a little more modestly.

4771. Mr. Millard Tucker: I think you might see what the company was arguing and what the Crown was arguing on the other side.

* The Iron and Steel Arbitration Tribunal sat in July, 1951, to determine the value, for compensation purposes, of the shares of the Staveley Iron & Chemical Co. Ltd.

The witness withdrew.